NINTH EDITION

Harold Koontz
Heinz Weihrich

# ESSENTIALS OF MANAGEMENT

## An International and Leadership Perspective

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# ESSENTIALS OF MANAGEMENT

## An International and Leadership Perspective

### Ninth Edition

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*(Late)*
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**Tata McGraw Hill Education Private Limited**
NEW DELHI

*McGraw-Hill Offices*

**New Delhi** New York St Louis San Francisco Auckland Bogotá Caracas
Kuala Lumpur Lisbon London Madrid Mexico City Milan Montreal
San Juan Santiago Singapore Sydney Tokyo Toronto

Tata McGraw-Hill

Published by the Tata McGraw Hill Education Private Limited,
7 West Patel Nagar, New Delhi 110 008.

**Essentials of Management: An International and Leadership Perspective, 9e**

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This edition can be exported from India only by the publishers,
Tata McGraw Hill Education Private Limited

ISBN-13: 978-1-25-900512-1
ISBN-10: 1-25-900512-7

Vice President and Managing Director: *Ajay Shukla*
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Publishing Manager—B&E/HSSL: *Tapas K Maji*
Deputy Manager (Sponsoring): *Surabhi Khare*
Assistant Sponsoring Editor: *Shalini Negi*
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Marketing Manager: *Vijay Sarathi*
Assistant Product Manager: *Daisy Sachdeva*
Graphic Designer (Cover Design): *Meenu Raghav*
General Manager—Production: *Rajender P Ghansela*
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Typeset at The Composers, 260, C.A. Apt., Paschim Vihar, New Delhi 110 063 and printed at

Cover Printer:

The McGraw·Hill Companies

# About the Authors

**Heinz Weihrich** is Professor of Global Management and Behavioral Sciences at the Dr. H.C. San Martin University, Peru before serving at the University of San Francisco. He received his doctorate from the University of California in Los Angeles (UCLA) and an honorary doctorate from San Martin de Porres University of Lima, Peru. He was a visiting scholar at the University of California in Berkeley, Harvard Business School and the KAIST Business School in Seoul. His field of work is management, international management, and behavioral science. Dr Weihrich has taught at Arizona State University, at UCLA, and in countries such as Austria, China (Beijing and Shanghai), Egypt, France (INSEAD), Germany, Hong Kong, Jamaica, Kuwait, Malaysia, Mexico, Singapore, Switzerland, Taiwan and Thailand. He was also a visiting professor at the Graduate School of Business (GBSA) in Zurich, Switzerland, at the China Europe International Business School (CEIBS) in Shanghai, at Chulalongkorn University in Bangkok, and at Peking University in Beijing.

Dr Weihrich has published more than 90 books, including various editions and translations, and is the author of the classic *Management*: *A Global Perspective* (which has been translated into more than 16 languages in its various editions) and *Essentials of Management* (also in several language editions), both formerly co-authored by the late Harold Koontz and the late Cyril O'Donnell. *Management* has been a worldwide bestseller for many years including in China. Its Spanish-language edition has topped the bestseller list for more than twelve years. Another book, *Management Excellence: Productivity through MBO*, discusses a goal-driven, success-oriented management system. It has been translated into six European and Asian languages. Over 140 of Weihrich's articles have been published in the United States and overseas in several languages in journals such as *Human Resource Planning, Journal of Systems Management, Management International Review, Long Range Planning, European Business Review* (in which one of his articles won the most outstanding paper in 1999), and the *Academy of Management Executive*. Dr Weihrich is the author of the TOWS Matrix, a widely used approach for strategy formulation and the analysis of the competitive advantage of nations. His current research interests are in improving the global competitiveness of enterprises and nations, strategic management, managerial excellence, and global leadership.

In addition to pursuing his academic interests, Dr Weihrich was active in management consulting as well as executive and organizational development in the United States, Europe, Africa, and Asia. His consulting, business, and teaching experiences include working with companies such as Eastman Kodak, Volkswagen, General Motors (UK), Hughes Aircraft, ABB (Switzerland), Mercedes-Benz, China Resources Co., Guangdong Enterprises (China), and the Institute Pembangunan Keusahawanan (Malaysia). He has given many speeches on management topics in the United States, Europe, Asia, Mexico, and Peru. He has been elected as a Fellow of the International Academy of

Management, the highest honor conferred by the international management movement. He is also listed in *International Businessmen's Who's Who, Men of Achievement, Dictionary of International Biography, International Leaders in Achievement, Who's Who in California, Who's Who in American Education, Marquis' Who's Who in the West, Who's Who in America,* and *Who's Who in the World.* More biographical information is published on his web site at *www.usfca.edu/fac-staff/weihrichh.*

**Harold Koontz** was active as a business and government executive, university professor, company board chairperson and director, management consultant, lecturer to the top management of organizations worldwide, and an author. From 1950 he was Professor of Management and from 1962 Mead Johnson Professor of Management at UCLA; from 1978 to 1982 he was World Chancellor at the International Academy of Management. He was the author or coauthor of 19 books and 90 journal articles, including this book, which was originally called *Principles of Management*. His *Board of Directors and Effective Management* was given the Academy of Management Book Award in 1968.

After his doctorate at Yale, Prof Koontz served as Assistant to the Trustees of the New Haven Railroad, Chief of the Traffic Branch of the War Production Board, Assistant to the Vice-President of the Association of American Railroads, Assistant to the President of Trans World Airlines, and Director of Sales for Convair. He acted as management consultant for, among others, Hughes Tool Company, Hughes Aircraft Company, Purex Corporation, KLM Royal Dutch Airlines, Metropolitan Life Insurance Company, Occidental Petroleum Corporation, and General Telephone Company. Professor Koontz's honors included election as a Fellow of the American Academy of Management and the International Academy of Management and a term of service as President of the former. He received the Mead Johnson Award in 1962 and the Society for Advancement of Management Taylor Key Award in 1974 and is listed in *Who's Who in America, Who's Who in Finance and Industry*, and *Who's Who in the World*. He passed away in 1984.

*To*

**My wife Ursula Weihrich**

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# Preface

The ninth edition of this book prepares men and women for a challenging and rewarding career of managing. This book is based on the classic best-selling book ***Management: A Global and Entrepreneurial Perspective*** which in its previous editions has been translated into some 16 languages. Each chapter in this book has been updated with recent management information. For example, Apple's iPad case is introduced in Chapter 1. As the title ***Essentials of Management: An International and Leadership Perspective*** indicates, the book takes an international view of managing with special attention given to leadership. As the world changes rapidly, this up-to-date edition is in response to these changes especially in Asia. Through our research, travels, and teaching in many countries, Professor Koontz and I have learned from students, managers, and professors, by listening to their challenges and analyzing them.

Previous editions of this book have been published in many languages. The international perspective will appeal to those realizing that the old barriers are fast disappearing and new alliances among companies and peoples are being formed. Several outstanding leaders in India illustrate the global nature of management. Beyond the discussion of managerial issues in America and Asia, attention is given to topics in the European Union and Latin America. The purpose of this book is to make readers better leaders by acquiring an international perspective and applying management principles, concepts, and theories in their work.

## Who Will Benefit from This Book?

All will benefit; including students in colleges and universities, aspiring managers, those who already have managerial skills, professionals, and nonmanagers who want to understand managing. This book is for people in all kinds of organizations, not just business firms; it is relevant to nonbusiness organizations such as government, health care, educational institutions, and not-for-profit enterprises as well.

Managerial functions are essentially the same for first-line supervisors, middle managers, and top executives. To be sure, there are considerable variations in environment, scope of authority, and types of problems in the various positions. Yet, all managers undertake the same basic functions to obtain results by establishing an environment for effective and efficient performance of individuals working together in groups.

## Organization of the Book

As in previous editions, managerial knowledge is classified according to the functions of planning, organizing, staffing, leading, and controlling. A systems model, shown on the inside book cover and used throughout the book, integrates these functions into a system; it also links the enterprise with its environment. The proposed open systems view is even more important now than in the past, as the external environment, through the internationalization, has become even more challenging.

Part 1 covers the basis of management theory and practice. It also introduces the systems model that serves as the framework of this book. To provide a comprehensive perspective, Part 1 includes chapters on management and its relations to the external environment, social responsibility, and ethics. Moreover, to emphasize the book's orientation, Part 1 also includes the chapter on international management. Parts 2 through 6 discuss the managerial functions of planning, organizing, staffing, leading, and controlling. The relevant principles, or guides, for each function highlight some key aspects of each managerial function.

## Revision Work in this Edition

***Essentials of Management: An International and Leadership Perspective,*** ninth edition, integrates theory and practice. While maintaining the global perspective, many examples and cases illustrate the application of concepts and theories to the **Indian environment.**

While the whole book has been updated, these examples illustrate new features in this edition:

- Who Manages Best in 2008, the Year of the Global Crisis?
- Energy Independence—The Need of the Time
- Is China Losing It's Competitive Advantage? Opportunities for India?
- Leadership Succession at the Tata Group?
- Learning Innovation from Emerging Countries
- Organizational Challenges at the TATA Conglomerate
- Wipro's Development Center in Atlanta
- How to Lead the Generation Xers?
- Meet Wipro's Azim Premji, India's Leading High-Tech Architect
- The Balanced Scoreboard
- WiMax a Breakthrough Technology
- Freeware: The Search for a Business Model

The aim of ***Essentials of Management: An International and Leadership Perspective*** is to make students and aspiring managers effective and efficient, and practicing managers more successful in achieving the aims of their organization.

## Learning Assistance

The integrative systems model on the inside of the book cover gives an overview of the book's content. The model is discussed in detail in Chapter 1. Parts 2 through 6 are introduced with this model and a parts overview highlights the chapters that are discussed in the respective part.

The chapters conclude with a summary, key ideas and concepts for review, and discussion questions. The purpose of the sections "Exercises/Action Steps" and "Internet Research" is to encourage readers' involvement. There is also one case for each chapter. At the end of chapters of the managerial functions (Parts 2 to 5), managerial principles, or guides, highlight some key concepts related to planning, organizing, staffing, leading, and controlling.

## Acknowledgments

The late Dr Harold Koontz is sorely missed. At a memorial session at the Academy of Management meeting, Professor Ronald Greenwood stated that Howdy Koontz was many years ahead of his time. Indeed, his inspiration and guidance popularized the classification of management knowledge according to the managerial functions, a framework now used around the world. He will never be forgotten for his contributions to management and those who read his many books, especially the first edition of the book ***Principles of Management*** with Cyril O'Donnell which, since then, has been continuously updated.

Professor Koontz and I are indebted to so many people contributing to the various editions that a complete acknowledgment would be encyclopedic. Many scholars, writers, and managers are acknowledged through references in the text. Many managers with whom we have served in business, government, education, and other enterprises have contributed by word and example. Thousands of managers in all kinds of enterprises in various countries have honored us over the years by allowing us to test our ideas in executive training classes and lectures. Especially helpful were the many experiences of executives around the world who have generously shared their international experiences. For example, the managers in MBA and executive programs in Egypt, Switzerland, Kuwait, Malaysia, Singapore, Thailand, and China provided opportunities to learn about their culture and their managerial practices. To the executives of these and the many other companies with whom we have been privileged to work as directors, consultants, or teachers, we are grateful for the opportunity to gain the clinical practice of managing.

Many colleagues, scholars, managers, and students have contributed their ideas and suggestions to this book. My good friend Professor Keith Davis at Arizona State University was particularly generous with his time. One of my mentors at UCLA, Professor George S Steiner, has done much to stimulate my interest in the development of the TOWS Matrix for strategy formulation. The late Professors Peter F Drucker and George S Odiorne, to whom my book ***Management Excellence—Productivity Through MBO*** has been dedicated, have sharpened my thinking about goal-driven management systems and managerial productivity. In previous editions, special appreciation was expressed to those who contributed in many important ways. While they are not named here, their contributions have been important for this edition as well.

We would like to thank the many adopters and contributors to this and previous editions of the book *Essentials of Management: An International Perspective*. We would also like to acknowledge the contributions of our fellow academicians who

have given their valuable feedback and suggestions on the previous editions as well as in the shaping of this edition. Some of them are:

1. Lipi Das, Institute of Management Technology, Ghaziabad
2. Richa Awasthy, International Management Institute, New Delhi
3. Pradeep Kautish, Jaipuria Institute of Management, Jaipur
4. Manjunath Subramanya, Sri Siddhartha Institute of Management Studies, Tumkur
5. Manodip Ray Chaudhuri, Future Business School, Kolkata
6. J Sathya Kumar, Thiagarajar School of Management, Madurai
7. S Mani, Sree Saraswathi Thyagaraja College, Coimbatore
8. Anil Sarin, International Management Education and Research Foundation, Faridabad
9. Manjunath VS, Nitte Meenakshi Institute of Technology, Bangalore
10. R Hamsalakshmi, Dr G R Damodaran College of Science, Coimbatore
11. T Bina, Happy Valley Business School, Coimbatore

Similarly, the editorial and managerial staff at Tata McGraw-Hill, Tapas Maji, Surabhi Khare, Shalini Negi, Manohar Lal and Atul Gupta have contributed significantly to this edition.

Finally, I want to thank my wife Ursula, to whom this book has been dedicated, for her continuing support.

**HEINZ WEIHRICH**

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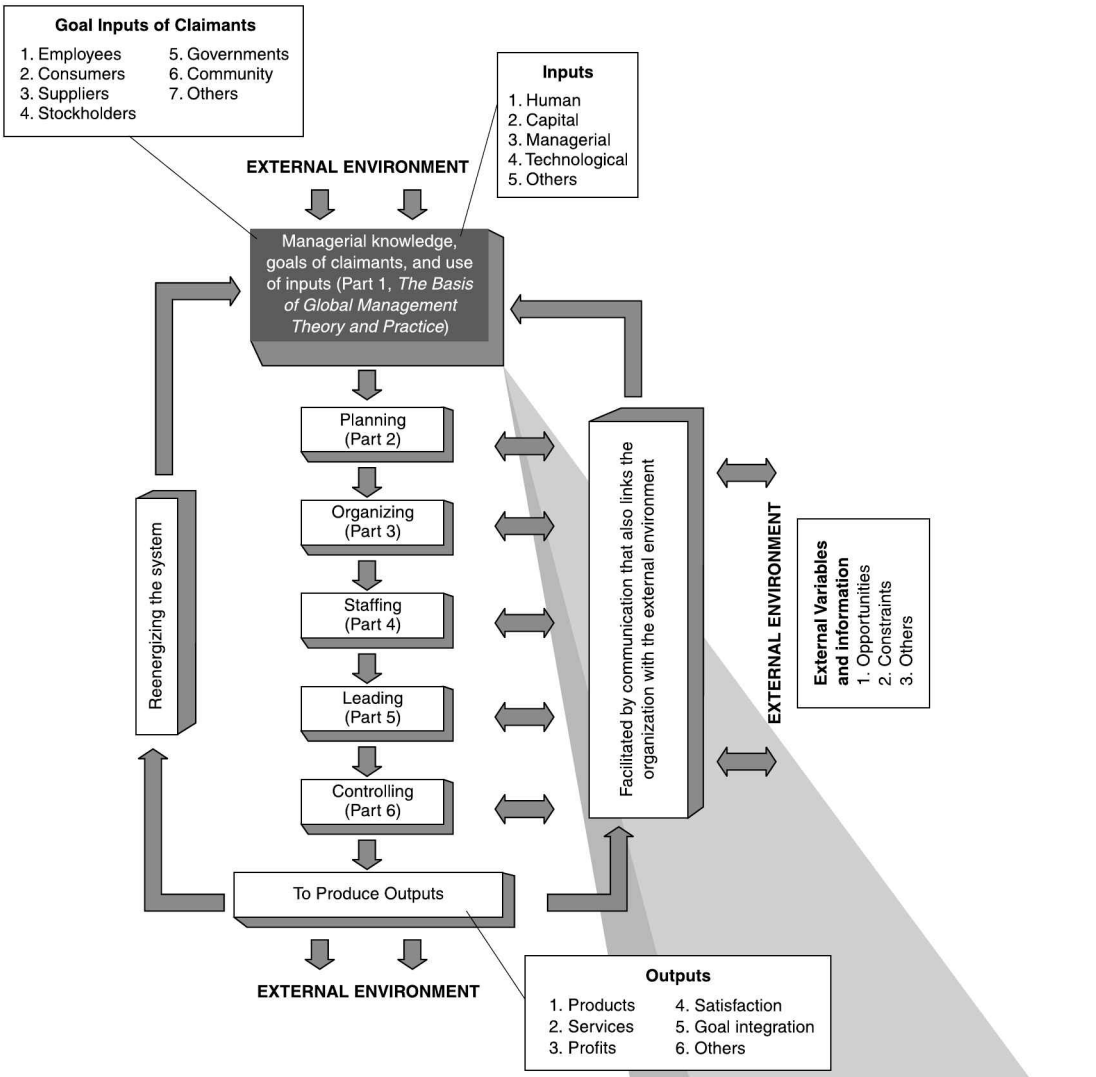


## SYSTEMS APPROACH TO MANAGEMENT: THE BASIS OF GLOBAL MANAGEMENT THEORY AND PRACTICE

Part 1

1. Management: Science, Theory, and Practice
2. Management and Society: The External Environment, Social Responsibility, and Ethics
3. Global, Comparative, and Quality Management

# 1 Management: Science, Theory, and Practice

## Chapter Objectives

After studying this chapter, you should be able to:

- Explain the nature and purpose of management
- Understand that management, as used in this book, applies to all kinds of organizations and to managers at all organizational levels
- Recognize that the aim of all managers is to create a surplus
- Identify the trends in information technology and globalization
- Explain the concepts of productivity, effectiveness, and efficiency
- Describe the evolution of management and some recent contributions to management thought
- Describe the various approaches to management, their contributions, as well as their limitations
- Show how the management process, or operational process, approach to management theory and science has a basic core of its own and draws from other approaches
- Realize that managing requires a systems approach and that practice must always take into account situations and contingencies
- Define the managerial functions of planning, organizing, staffing, leading, and controlling
- Understand how this book is organized

One of the most important human activities is managing. Ever since people began forming groups to accomplish aims they could not achieve as individuals, managing has been essential to ensure the coordination of individual efforts. As society has come to rely increasingly on group effort, and as many organized groups have become large, the task of managers has been rising in importance. The purpose of this book is to promote excellence among all persons in organizations, especially among managers, aspiring managers, and other professionals.*

*At times, the term *nonmanager* is used in reference to persons who have no subordinates. Thus, nonmanagers include professionals who may have a high status in organizations.

## DEFINITION OF MANAGEMENT: ITS NATURE AND PURPOSE

**Management** The process of designing and maintaining an environment in which individuals, working together in groups, efficiently accomplish selected aims.

**Management** is the process of designing and maintaining an environment in which individuals, working together in groups, efficiently accomplish selected aims. This basic definition needs to be expanded:

- As managers, people carry out the managerial functions of planning, organizing, staffing, leading, and controlling.
- Management applies to any kind of organization.
- It applies to managers at all organizational levels.
- The aim of all managers is the same: to create a surplus.
- Managing is concerned with productivity, which implies effectiveness and efficiency.

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Here are some managers you may know: Steve Jobs at Apple Computer; Bill Ford, Jr., at Ford Motor Company; Jack Welch of General Electric and his successor, Jeff Immelt; Cisco's John Chambers; and Bill Gates of Microsoft. One of the most powerful managers is Barack Obama, President of the United States. The Governor of the State of California is also a manager and, in some ways, so is Pope Benedict XVI, the head of the Roman Catholic Church, one of the largest global organizations. But middle-level managers and first-line supervisors also make important contributions to the goal of their organizations.

All do manage organizations. We define an **organization** as a group of people working together to create a surplus. In business organizations, this surplus is profit. In nonprofit organizations, such as charitable organizations, it may be satisfaction of needs. Universities also create a surplus through generation and dissemination of knowledge as well as providing service to the community or society.

### The Functions of Management

Five managerial functions around which managerial knowledge is organized in this book: planning, organizing, staffing, leading, and controlling.

Many scholars and managers have found that the analysis of management is facilitated by a useful and clear organization of knowledge. In studying management, therefore, it is helpful to break it down into five managerial functions—planning, organizing, staffing, leading, and controlling—around which the knowledge that underlies those functions can be organized. Thus, the concepts, principles, theories, and techniques of management are grouped into these five functions in this book.

This framework has been used and tested for many years. Although there are different ways of organizing managerial knowledge, most textbooks and authors today have adopted this or a similar framework even after experimenting at times with alternative ways of structuring knowledge.

External elements that affect operation: economic, technological, social, ecological, political, and ethical factors.

Although the emphasis in this book is on managers' tasks that pertain to designing an internal environment for performance within an organization, it must never be overlooked that managers must operate in the external environment of an enterprise as well. Clearly, managers cannot perform their tasks well unless they have an understanding of, and are responsive to, the many elements of the external environment—economic, technological, social, ecological, political, and ethical factors—that affect their areas of operation. Moreover, many organizations now operate in different countries. Therefore, this book takes a global perspective of managing. Creative individuals greatly contribute to value creation.

## Management as an Essential for Any Organization

**Enterprise** A business, government agency, hospital, university, or any other type of organization.

Managers are charged with the responsibility of taking actions that will enable individuals to make their best contributions to group objectives. Management thus applies to small and large organizations, to profit and not-for-profit enterprises, to manufacturing as well as service industries. The term **enterprise** refers to a business, government agency, hospital, university, and any other type of organization, since almost everything said in this book refers to business as well as nonbusiness organizations. Effective management is the concern of the corporation president, the hospital administrator, the government first-line supervisor, the Boy Scout leader, the church bishop, the baseball manager, and the university president.

## Managerial Functions at Different Organizational Levels

In this book, no basic distinction is made between managers, executives, administrators, and supervisors. To be sure, a given situation may differ considerably between various levels in an organization or between various types of enterprises. Similarly, the scope of authority held may vary and the types of problems dealt with may be considerably different. Furthermore, the person in a managerial role may be directing people in the sales, engineering, or finance department. But the fact remains that, as managers, all obtain results by establishing an environment for effective group endeavor.

All managers carry out managerial functions, but the time spent for each function may differ.

All managers carry out managerial functions. However, the time spent for each function may differ. Figure 1.1 shows an approximation of the relative time spent for each function. Thus, top-level managers spend more time on planning and organizing than do lower-level managers. Leading, on the other hand, takes a great deal of time for first-line supervisors. The difference in time spent on controlling varies only slightly for managers at various levels.

## Managerial Skills and the Organizational Hierarchy

Robert L. Katz identified three kinds of skills for administrators.[1] To these, may be added a fourth—the ability to design solutions.

Four skills required of administrators: technical, human, conceptual, and design skills.

The relative importance of these skills may differ at various levels in the organizational hierarchy. As shown in Figure 1.2, *technical skills* are of greatest importance at the supervisory level, and *human skills* are helpful in the frequent interactions with subordinates. *Conceptual and design skills*, on the other hand, are usually not critical for lower-level supervisors. At the middle management level, the need for technical skills decreases, human skills are still essential, while conceptual skills gain in importance. At the top management level, conceptual and design abilities and human skills are especially valuable, but there is relatively little need for technical abilities. It is assumed, especially in large companies, that chief executive officers (CEOs) can utilize the technical abilities of their subordinates. In smaller firms, however, technical experience may still be quite important.

**Figure 1.1**

**Time Spent in Carrying Out Managerial Functions.**

**Partly based on and adapted from Thomas A. Mahoney, Thomas H. Jerdee, and Stephen J. Carroll, "The Job(s) of Management," *Industrial Relations* (February 1965) pp. 97–110.**

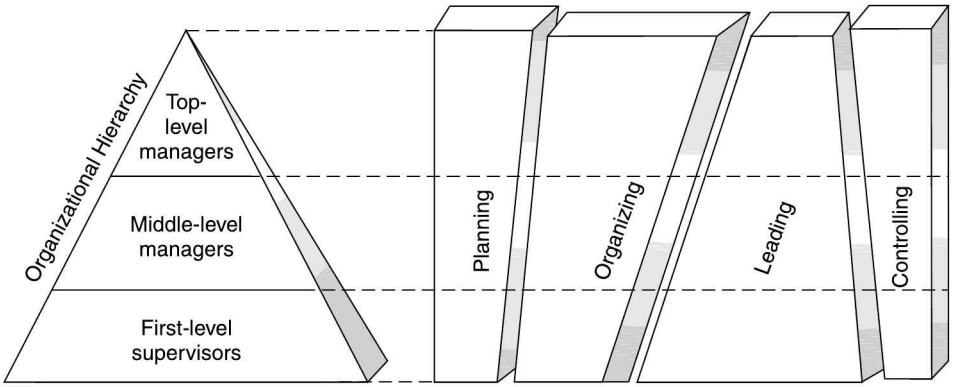
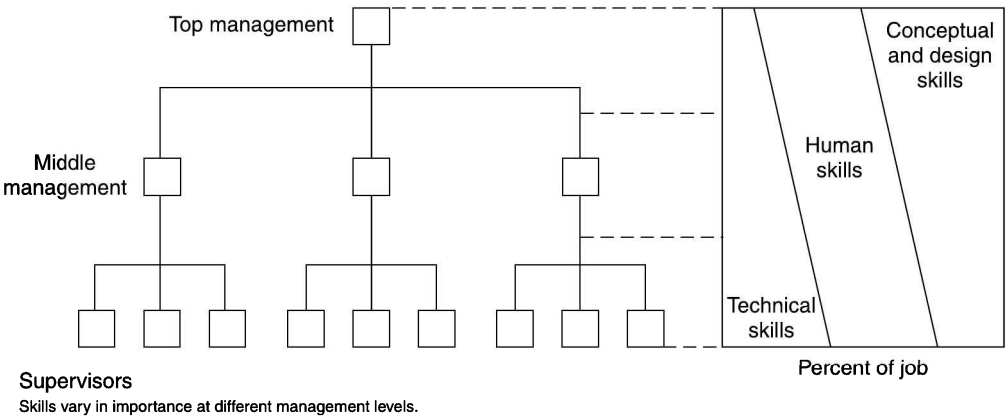



**Figure 1.1**

**Skills and Management Levels.**




Skills vary in importance at different management levels.

## The Goals of All Managers and Organizations

Nonbusiness executives sometimes say that the aim of business managers is simple—to make a profit. But profit is really only a measure of a surplus of sales receipts over expenses. For many businesses, an important goal is the long-term increase in the value of their common stock. Michael Porter at Harvard is critical about the emphasis of shareholder value when he wrote that "we lost sight of profitability as the goal and substituted shareholder value measured by stock price."[2] This, Porter suggests, has destroyed many enterprises. In a very real sense, in all kinds of organizations, whether business or nonbusiness, the logical and publicly desirable aim

The aim of all managers should be to create a surplus, by establishing an environment in which people can accomplish group goals with the least amount of time, money, materials, and personal dissatisfaction.

of all managers should be a *surplus*. Thus, managers must establish an environment in which people can accomplish group goals with the least amount of time, money, materials, and personal dissatisfaction, or in which they can achieve as much as possible of a desired goal with available resources. In a nonbusiness enterprise such as a police department, as well as in units of a business that are not responsible for total business profits (such as the accounting department), managers still have goals and should strive to accomplish them with the minimum of resources or to accomplish as much as possible with available resources.

**LEADERSHIP PERSPECTIVE**

## Who Managed Best in 2008, the Year of the Global Crisis?[3]

The year 2008 was a year of economic crises around the world. Who managed best during such times? Business Week identified twelve executives who performed well during difficult times. Here are some examples and what one can learn from them:

*Jim Sinegal, the CEO of Costco,* did not raise prices despite rising costs. This helped the company to gain market share. The members-only retail chain achieved that 87 percent of members renewed their membership. Sinegal's common-sense approach to management worked well.

*Frank Blake, the CEO of Home Depot,* simplified his company and increased morale among its employees. He thinks that people should feel comfortable in speaking their minds. He *yearly* also visits Jack Welch, the former GE CEO, for advice.

*Mark Hurd, the CEO of Hewlett Packard,* was successful by keeping his eyes on cost, improving efficiency, and focusing on innovation. He got rid of businesses that were not No. 1 or No. 2 in their field. This is similar to Jack Welch's early approach at GE.

*David Axelrod, main strategist of the Obama campaign,* helped Obama to the presidency of the United States of America. He helped communicate Obama's vision of change. He recruited effective people who worked well together with good conflict resolution. He viewed himself as the messenger for Barack Obama.

There are also Non-American executives *who were* among the best managers in 2008:

*Satoru Iwata, CEO of Nintendo in Tokyo,* doubled the sales of the successful Wii. Consumers spent money on this innovative product despite *the* hard economic times. He planned to continue redefining games, music, camera, and even health management features.

*Takeo Fukui, CEO of Honda in Tokyo,* continued to focus on fuel-efficient small cars with his efforts on innovation and research. His managerial approach was and is influenced by the classic American book "How to Stop Worrying and Start Living" by Dale Carnegie.

*Peter Loscher, CEO of Siemens in Munich,* did a good job of restructuring the company while at the same time dealing with the corruption and foreign bribery charges. His advice: "Listen, and then make clear decisions."

*Jeroen Van Der Veer, CEO of Royal Dutch Shell in the Netherlands,* is guided by the philosophy of: Eliminate, Simplify, Standardize, and Automate.[4]

■■

## Characteristics of Excellent and Most Admired Companies

In the United States, profitability is an important measure of company excellence. At times, however, other *success* criteria are also used that frequently coincide with financial performance. In their book *In Search of Excellence*, Thomas Peters and Robert Waterman identified 43 companies that they regarded as excellent.[5] In choosing the firms, they considered factors such as growth of assets and equity, average return on total capital, and similar measures. They also asked industry experts about the innovativeness of the companies.

The authors identified eight characteristics of excellent enterprises. Specifically, these firms:

1. were oriented toward action
2. learned about the needs of their customers
3. promoted managerial autonomy and entrepreneurship
4. achieved productivity by paying close attention to the needs of their people
5. were driven by a company philosophy often based on the values of their leaders
6. focused on the business they knew best
7. had a simple organization structure with a lean staff
8. were centralized as well as decentralized, depending on appropriateness

Two years after *In Search of Excellence* was published, *Business Week* took a second look at the companies that Peters and Waterman had considered excellent.[6] The magazine's survey revealed that at least 14 of the 43 companies did not measure up very well to several of the eight characteristics of excellence. Nine companies showed a great decline in earnings. While Peters and Waterman have been criticized in several respects (e.g., their methods of collecting and interpreting the data, such as extensive use of anecdotes and quotations from leaders in the field rather than using more scientific research sources), the performance review of the firms indicated that success may be only transitory and that it demands continuing hard work to adapt to the changes in the environment.[7]

INTERNATIONAL PERSPECTIVE

### Asia Business Week Ranking of the Top 50 Companies[8]

Among the Standard & Poor's Compustat rankings of 50 Asian companies, ten are Indian and five are Chinese companies. Siemens (India), which is a communications equipment company, ranked No. 1. The second highest ranking was Unitech, a Real Estate firm. Cipla Pharmaceuticals ranked sixth. The Alibaba.com, the Chinese Internet Services company, ranked third. However, it should be noted that this company is expanding to India partly because of China's strong currency.[9] Other Indian companies among the top 20 are: Asea Brown Boveri India (electrical equipment), Tech Mahindra (Tech Services), Hindustan Zinc (metals and mining), and DLF (real estate).

The top 50 listings also include companies from Hong Kong, Malaysia, Indonesia, Taiwan, Singapore, Korea, and Pakistan. But India is represented with most firms (10 companies) followed by Hong Kong with nine. ■■

## Advances in Technologies, Trends in Globalization, and a Focus Entrepreneurship for Adapting to Changes in the 21st Century

To be successful in the 21st century, companies must take advantage of information technology—especially the Internet—globalization—and entrepreneurship.

To be successful in the 21st century, companies must take advantage of the new information technology—especially the Internet—globalization—and entrepreneurship.

**Technology[10]** Technology, and especially information technology (IT) has a pervasive impact on both organizations and individuals. The World Wide Web and the Internet connects people and organizations through a global network. Electronic commerce (e-commerce) is increasingly used for transactions between individuals and companies (B2C) as well as between businesses (B2B). The number of people connecting to the Internet varies among countries. The United States, Canada, the Nordic countries in Europe, and Australia have high network access rates, and so do many Asian countries. For example, Shanghai, China, has a population of 18 million and over 16 million cell phone subscribers.[11] But other countries, including developing countries, are rapidly connecting to the global network.

Another trend is the use of m-commerce, that is, mobile or wireless commerce for buying and selling goods using, for example, cellular telephones or personal digital assistants. Increasingly, people can communicate without computers by using wireless devices. In Japan, for example, NTT DoCoMo has developed an Internet service called i-mode, which already has many million subscribers.[12] These services will increase as soon as third-generation wireless technology makes the speedy transmission of data (including video) possible. These and other technology trends are so important that they will be further discussed in Chapter 19.

**Globalization**[13] The second major trend is globalization. Most major corporations have an international presence. The World Trade Organization (WTO), an umbrella organization, was established in 1995 to govern international trade. Despite street protests at WTO meetings, globalization continues. The gains from globalization not only benefit Western corporations but also result in higher incomes for people in other countries, such as China. Clearly, managers must develop an international perspective. Chapter 3 will address several global issues in detail. In addition, international topics are discussed in the international perspectives shown throughout the book.

## Productivity, Effectiveness, and Efficiency

Another way to view the aim of managers is that they must raise productivity. After World War II, the United States became the world leader in productivity. But in the late 1960s, productivity growth began to decelerate. Today, the urgent need for productivity improvement is recognized around the world by governments, industry, and universities. Often one looks to Japan to find answers to our productivity problem (a subject to be considered later in Chapter 3), but what tends to be overlooked is the importance of effectively performing basic managerial and nonmanagerial activities.

**Productivity** The output—input ratio within a time period with due consideration for quality.

**Definition of productivity** Successful companies create a surplus through productive operations. Although there is no complete agreement on the true meaning of **productivity**, let us define it as the output–input ratio within a time period with due consideration for quality. It can be expressed as follows:

$$\text{Productivity} = \frac{\text{Outputs}}{\text{Inputs}} \text{ (within a time period, quality considered)}$$

The formula indicates that productivity can be improved by (1) increasing outputs with the same inputs, (2) decreasing inputs but maintaining the same outputs, or (3) increasing outputs and decreasing inputs to change the ratio favorably. Companies use several kinds of inputs, such as labor, materials, and capital. Total-factor productivity combines various inputs to arrive at a composite input. In the past, productivity improvement programs were mostly aimed at the worker level. Yet, as Peter F. Drucker, one of the most prolific writers in management, observed, "The greatest opportunity for increasing productivity is surely to be found in knowledge work itself, and especially in management."[14]

**Effectiveness** The achievement of objectives.

**Efficiency** The achievement of the ends with the least amount of resources.

**Definitions of effectiveness and efficiency** Productivity implies effectiveness and efficiency in individual and organizational performance. **Effectiveness** is the achievement of objectives. **Efficiency** is the achievement of the ends with the least amount of resources. Managers cannot know whether they are productive unless they first know their goals and those of the organization, a topic that will be discussed in Chapter 4.

## MANAGING: SCIENCE OR ART?[15]

Managing as practice is an art; the organized knowledge underlying the practice is a science.

Managing, like all other practices—whether medicine, music composition, engineering, accountancy, or even baseball—is an art. It is know-how. It is doing things in light of the realities of a situation. Yet managers can work better by using the organized knowledge about management. It is this knowledge that constitutes a science. Thus, managing as practice is an *art*; the organized knowledge underlying the practice may be referred to as a *science*. In this context, science and art are not mutually exclusive; they are complementary.

As science improves, so should art, as has happened in the physical and biological sciences. To be sure, the science underlying managing is fairly crude and inexact because the many variables that managers deal with are extremely complex. Nevertheless, such management knowledge can certainly improve managerial practice. Physicians without the advantage of science would be little more than witch doctors. Executives who attempt to manage without management science must trust luck, intuition, or do what they did in the past.

In managing, as in any other field, unless practitioners are to learn by trial and error (and it has been said that managers' errors are their subordinates' trials), there is no place they can turn to for meaningful guidance other than the accumulated knowledge underlying their practice.

## THE EVOLUTION OF MANAGEMENT THOUGHT

Many different contributions of writers and practitioners have resulted in different approaches to management, and these make up a "management theory jungle." Later in this chapter, you will learn about the different patterns of management analysis and what can be done to untangle the jungle. Table 1.1 summarizes the major contributions of management writers and practitioners.[16] We will highlight Frederick Taylor's scientific management, Henri Fayol's modern operational management theory, and Elton Mayo and F. J. Roethlisberger's Hawthorne studies.

**Frederick W. Taylor**
(1856–1915)

### Frederick Taylor and Scientific Management[17]

Frederick Winslow Taylor gave up going to college and started out as an apprentice pattern maker and machinist in 1875, joined the Midvale Steel Company in Philadelphia as a machinist in 1878, and rose to the position of chief engineer after earning a degree in engineering through evening study. He invented high-speed steel-cutting tools and spent most of his life as a consulting engineer. Taylor is generally acknowledged as the father of

**Table 1.1** The Emergence of Management Thought

| *Name and year of major work* | *Major contribution to management* |
|---|---|
| **Scientific management** | |
| Frederick W. Taylor<br>*Shop Management* (1903)<br>*Principles of Scientific Management* (1911)<br>*Testimony before the Special House Committee* (1912) | Acknowledged as the father of scientific management. His primary concern was to raise productivity through greater efficiency in production and increased pay for workers, by applying the scientific method. His principles emphasize using science, creating group harmony and cooperation, achieving maximum output, and developing workers. |
| Henry L. Gantt (1901) | Called for scientific selection of workers and "harmonious cooperation" between labor and management. Developed the Gantt chart (Chapter 19). Stressed the need for training. |
| Frank and Lillian Gilbreth (1900) | Frank is known primarily for his time and motion studies. Lillian, an industrial psychologist, focused on the human aspects of work and the understanding of workers' personalities and needs. |
| **Modern operational management theory** | |
| Henri Fayol<br>*Administration Industrielle et Générale* (1916) | Referred to as the father of modern management theory. Divided industrial activities into six groups: technical, commercial, financial, security, accounting, and managerial. Recognized the need for teaching management. Formulated 14 principles of management, such as authority and responsibility, unity of command, scalar chain, and esprit de corps. |
| **Behavioral sciences** | |
| Hugo Münsterberg (1912) | Application of psychology to industry and management. |
| Walter Dill Scott (1910, 1911) | Application of psychology to advertising, marketing, and personnel. |
| Max Weber (translations 1946, 1947) | Theory of bureaucracy. |
| Vilfredo Pareto (books 1896–1917) | Referred to as the father of the social systems approach to organization and management. |
| Elton Mayo and F. J. Roethlisberger (1933) | Famous studies at the Hawthorne plant of the Western Electric Company on the influence of social attitudes and relationships of work groups on performance. |
| **Systems theory** | |
| Chester Barnard<br>*The Functions of the Executive* (1938) | The task of managers is to maintain a system of cooperative effort in a formal organization. Suggested a comprehensive social systems approach to managing. |
| **Modern management thought** | |
| Many authors are discussed in this book. Major contributors include Chris Argyris, Robert R. Blake, C. West Churchman, Ernest Dale, Keith Davis, Mary Parker Follett, Frederick Herzberg, G. C. Homans, Harold Koontz, Rensis Likert, Douglas McGregor, Abraham H. Maslow, Lyman W. Porter, Herbert Simon, George A. Steiner, Lyndall Urwick, Norbert Wiener, and Joan Woodward. | |

(*Contd.*)

**Table 1.1** (*Contd.*)

| *Name and year of major work* | *Major contribution to management* |
|---|---|
| Peter F. Drucker (1974) | Very prolific writer on many general management topics. |
| W. Edwards Deming (after World War II) | Introduced quality control in Japan. |
| Laurence Peter (1969) | Observed that eventually people get promoted to a level where they are incompetent. |
| William Ouchi (1981) | Discussed selected Japanese managerial practices adapted in the U.S. environment. |
| Thomas Peters and Robert Waterman (1982) | Identified characteristics of companies they considered excellent. |

*Source:* Some information in this table is based on Claude S. George, Jr., *The History of Management Thought* (Englewood Cliffs, New Jersey: Prentice Hall, 1972).

scientific management. Probably no other person has had a greater impact on the early development of management. His experiences as an apprentice, a common laborer, a foreman, a master mechanic, and then the chief engineer of a steel company gave Taylor ample opportunity to know first-hand the problems and attitudes of workers and to see the great possibilities for improving the quality of management.

Taylor's famous work *Principles of Scientific Management* was published in 1911. The fundamental principles that Taylor saw underlying the scientific approach to management are as follows:

- Replacing rules of thumb with science (organized knowledge)
- Obtaining harmony, rather than discord, in group action
- Achieving cooperation of human beings, rather than chaotic individualism
- Working for maximum output, rather than restricted output
- Developing all workers to the fullest extent possible for their own and their company's highest prosperity

You will notice that these basic precepts of Taylor's are not far from the fundamental beliefs of the modern manager.

## Henri Fayol, the Father of Modern Management Theory [18]

**Henri Fayol** (1841–1925)

Perhaps the real father of modern management theory is the French industrialist Henri Fayol. He recognized a widespread need for principles and management teaching. Consequently, he identified 14 such principles, noting that they are flexible, not absolute, and must be usable regardless of changing conditions. Let us look at some of these principles:

- *Authority and responsibility*. Fayol suggests that authority and responsibility are related, with the latter arising from the former. He sees authority as a combination of official factors, deriving

from the manager's position, and personal factors, "compounded of intelligence, experience, moral worth, past service, etc."

- *Unity of command*. Employees should receive orders from one superior only.
- *Scalar chain*. Fayol thinks of this as a "chain of superiors" from the highest to the lowest ranks, which, while not to be departed from needlessly, should be short-circuited when following it scrupulously would be detrimental.
- *Esprit de corps*. This is the principle that "in union there is strength," as well as an extension of the principle of unity of command, emphasizing the need for teamwork and the importance of communication in obtaining it.

Fayol regarded the elements of management as the functions of planning, organizing, commanding, coordinating, and controlling.

## Elton Mayo and F. J. Roethlisberger and the Hawthorne Studies

www.thoemmes.com/encyclopedia/mayo.htm

Elton Mayo, F. J. Roethlisberger, and others undertook the famous experiments at the Hawthorne plant of the Western Electric Company between 1927 and 1932.[19] Earlier, from 1924 to 1927, the National Research Council made a study in collaboration with Western Electric to determine the effect of illumination and other conditions on workers and their productivity. Finding that productivity improved when illumination was either increased or decreased for a test group, the researchers were about to declare the whole experiment a failure. However, Mayo of Harvard saw in it something unusual and, with Roethlisberger and others, continued the research.

**Elton Mayo** (1880–1949)

What Mayo and his colleagues found, partly on the basis of the earlier thinking of Vilfredo Pareto, was to have a dramatic effect on management thought. Changing illumination for the test group, modifying rest periods, shortening workdays, and varying incentive pay systems did not seem to explain changes in productivity. Mayo and his researchers then came to the conclusion that other factors were responsible. They found, in general, that the improvement in productivity was due to such social factors as morale, satisfactory interrelationships between members of a work group (a sense of belonging), and effective management—a kind of managing that takes into account human behavior, especially group behavior, and serves it through such interpersonal skills as motivating, counseling, leading, and communicating. This phenomenon, arising basically from people being "noticed," has been named the Hawthorne effect.

## Recent Contributors to Management Thought

Among the contributors to management thought are public administrators, business managers, and behavioral scientists, whose important works are discussed throughout this book. We will mention only a few here.

Peter F. Drucker has written on a variety of general management topics. Keith Davis helped us understand the informal organization. The late W. Edwards Deming[20] and Joseph M. Juran,[21] two Americans, did much to improve the quality of Japanese products. The late Laurence Peter suggested that eventually people get promoted to a level where they are incompetent and no further promotion is possible. Unfortunately, this may result in organizations with incompetent people. William Ouchi, who wrote the best-selling book *Theory Z*, showed how selected Japanese management practices may be adapted in the United States. Finally, Thomas Peters and Robert Waterman discussed characteristics of excellent companies. Most of these works are discussed in greater detail in other parts of this book.

**INTERNATIONAL PERSPECTIVE**

## The Wisdom of Peter Drucker[22]

The late Peter Drucker was one of the most influential management thinkers. During his 60-year career, he wrote 39 books and consulted with executives of major companies. However, his interests were not restricted to managerial insights, but extended to Japanese art and European history. Yet, his focus was on making workers more productive. He popularized Management by Objectives in his classic book *The Practice of Management* in which he emphasized the importance of having a clear purpose and the setting of verifiable objectives. This means that objectives are verifiable if at the end of the period one can see whether the objective has been achieved.

Drucker consulted with CEOs of major companies such as Jack Welch, the former CEO of General Electric (GE) who is considered by many as the most effective executive manager of a large complex organization. Drucker's questioning may have lead to Welch's axiom which suggested that if one of GE's business units is not No. 1 or No. 2 in its industry (or has a good chance to become so) it should be discarded. Drucker's effectiveness was in raising important questions. One top manager asked why he should pay Drucker's consulting fees if the CEO was to answer all the questions. However, Drucker's questioning approach often led to identifying the direction the company should go. Andrew Grove, the former CEO at Intel was impressed by Drucker's discussion of the multiple roles of the CEO, namely that of presenting the firm to the public, the role of the strategist, and that of the operational manager. Moreover, Drucker suggested that a manager should not be promoted on his or her potential, but on performance.

In 1943 he studied the organizational structure of GM which resulted in the book *The Concept of the Corporation.* His view was that "it takes people capable of joint performance, to make their strengths effective and weaknesses irrelevant."

Drucker had a deep concern not only for making workers more productive, but that employees are the organization's most valuable assets and that decision-making should be pushed down in the organization to the lowest levels in the hierarchy

(i.e. delegation). Some other nuggets of his managerial philosophy are that at the centre of the organization are human beings—not machines or buildings. He also suggested that managers do the same in the United States, Germany, Japan, China, but how they do it may be different.

Organizational learning, training, and development need to be done at all levels of the organization. It is a continuing effort. Profitability is not the purpose but a necessity in organizations. Marketing starts with the customer and his or her values and needs. He asked questions such as: Where do the customers live and what do they want to buy? Seems simple? Yes, but it is powerful for an effective strategy.

Long before it was generally recognized, Drucker popularized the notion of the "knowledge worker" and the special considerations for managing him or her. But management is not only for profit-oriented enterprises, but also for churches, labor unions, youth groups, and hospitals, a view that is emphasized in this book. ■■

## PATTERNS OF MANAGEMENT ANALYSIS: A MANAGEMENT THEORY JUNGLE

Although academic writers and theorists contributed notably little to the study of management until the early 1950s (previous writings having come largely from practitioners), the past several decades have seen a veritable deluge of writing from the academic halls. The variety of approaches to management analysis, the amount of research, and the great number of differing views have resulted in much confusion as to what management is, what management theory and science are, and how managerial events should be analyzed. As a matter of fact, Harold Koontz many years ago called this situation "the management theory jungle."[23] Since that time, the vegetation in this jungle has changed somewhat—new approaches have developed and older approaches have taken on some new meanings with some new words attached, but the developments of management science and theory still have the characteristics of a jungle.

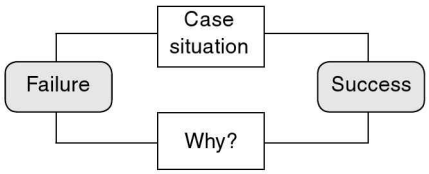
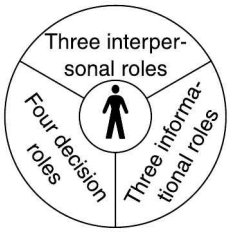
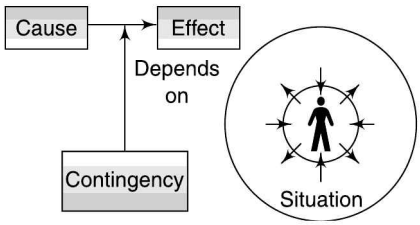
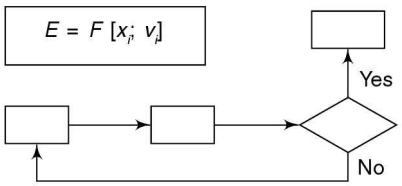
The various approaches to management analysis are summarized in Figure 1.3, where they are grouped into 14 categories. The characteristics, contributions, and limitations of each approach are shown in the figure. We will focus here on the managerial roles approach and the management process (or operational) approach.

### The Managerial Roles Approach

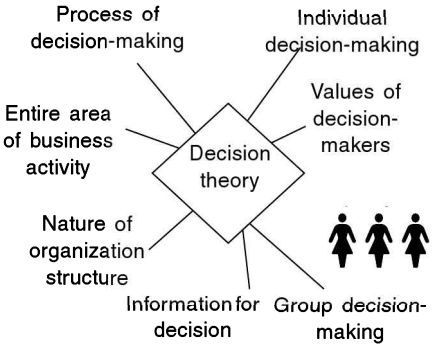
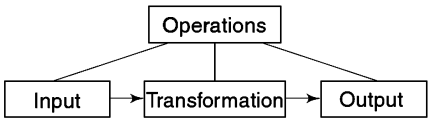
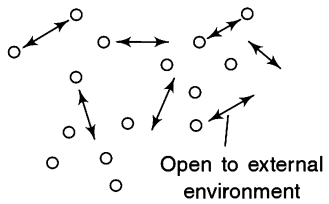
One widely discussed approach to management theory is the managerial roles approach, popularized by Henry Mintzberg of McGill University.[24] Essentially, his approach is to observe what managers actually do and from such observations come to conclusions as to what managerial activities (or roles) are. Although many researchers have studied the actual work of managers—from CEOs to line supervisors—Mintzberg has given this approach higher visibility.

**Figure 1.3**

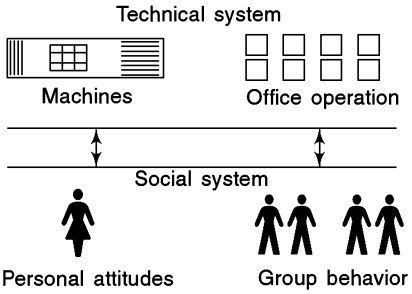
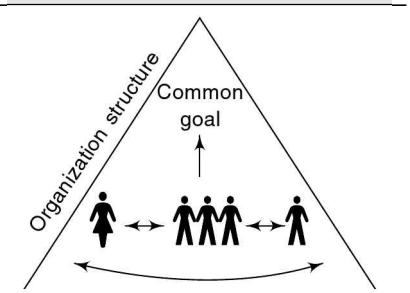
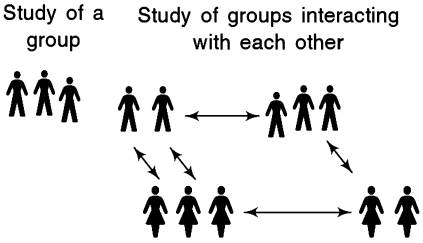
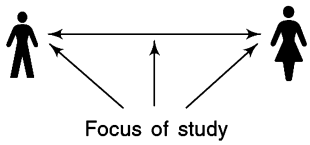
**Approaches to Management.**

| Characteristics/ Contributions | Limitations | Illustration |
|---|---|---|
| EMPIRICAL OR CASE APPROACH | | |
| Studies experience through cases. Identifies successes and failures. | Situations are all different. No attempt to identify principles. Limited value for developing management theory. |   |
| MANAGERIAL ROLES APPROACH | | |
| Original study consisted of observations of five chief executives. On the basis of this study, ten managerial roles were identified and grouped into interpersonal, informational, and decision roles. | Original sample was very small. Some activities are not managerial. Many activities are evidence of planning, organizing, staffing, leading, and controlling. Some important managerial activities are left out (e.g., appraising managers). | Roles of managers   |
| CONTINGENCY OR SITUATIONAL APPROACH | | |
| Managerial practice depends on circumstances (i.e., a contingency or a situation). Contingency theory recognizes the influence of given solutions on organizational behavior patterns. | Managers have long realized that there is no one best way to do things. Difficult to determine all relevant contingency factors and to show their relationships. Can be very complex. |   |
| MATHEMATICAL OR "MANAGEMENT SCIENCE" APPROACH | | |
| Sees managing as mathematical processes, concepts, symbols, and models. Looks at management as a purely logical process, expressed in mathematical symbols and relationships. | Preoccupation with mathematical models. Many aspects in managing cannot be modeled. Mathematics is a useful tool, but hardly a school or an approach to management. |   |

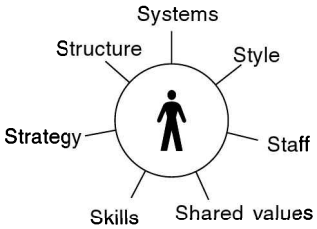
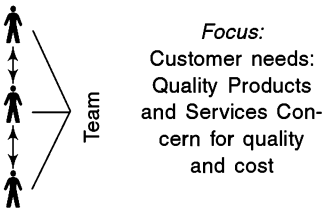
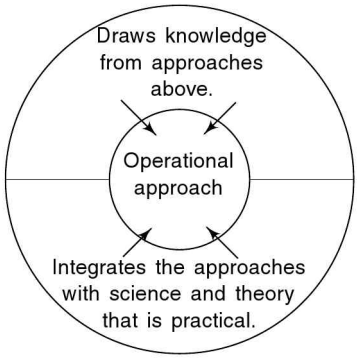
(*Contd.*)

| Characteristics/ Contributions | Limitations | Illustration |
|---|---|---|
| | DECISION THEORY APPROACH | |
| Focuses on the making of decisions, persons or groups making decisions, and the decision-making process. Some theorists use decision-making as a springboard to study all enterprise activities. The boundaries of study are no longer clearly defined. | There is more to managing than making decisions. The focus is at the same time too narrow and too wide. |  |
| | REENGINEERING APPROACH | |
| Concerned with fundamental rethinking, process analysis, radical redesign, and dramatic results. | Neglects external environment. Possibly ignores customers' needs. Neglects human needs. Ignores total management system, unlike the management process, or operational approach. |  |
| | SYSTEMS APPROACH | |
| Systems concepts have broad applicability. Systems have boundaries, but they also interact with the external environment; that means organizations are open systems. Recognizes the importance of studying interrelatedness of planning, organizing, and controlling in an organization as well as in the many subsystems. | Can hardly be considered a new approach to management, as claimed by some proponents of this approach. |  |

(*Contd.*)

| Characteristics/ Contributions | Limitations | Illustration |
|---|---|---|
| SOCIOTECHNICAL SYSTEMS APPROACH | | |
| Technical system has a great effect on social system (personal attitudes, group behavior). Focuses on production, office operations, and other areas with close relationships between the technical system and people. | Emphasizes only blue-collar and lower-level office work. Ignores much of other managerial knowledge. |   |
| COOPERATIVE SOCIAL SYSTEMS APPROACH | | |
| Concerned with both interpersonal and group behavioral aspects leading to a system of cooperation. Expanded concept includes any cooperative group with a clear purpose. | Too broad a field for the study of management. At the same time, it overlooks many managerial concepts, principles, and techniques. |   |
| GROUP BEHAVIOR APPROACH | | |
| Emphasizes behavior of people in groups. Based on sociology and social psychology. Primarily studies group behavior patterns. The study of large groups is often called organizational behavior. | Often not integrated with management concepts, principles, theory, and techniques. Need for closer integration with organizational structure design, staffing, planning, and controlling. |   |
| INTERPERSONAL BEHAVIOR APPROACH | | |
| Focuses on interpersonal behavior, human relations, leadership, and motivation. Based on individual psychology. | Ignores planning, organizing, and controlling. Psychological training is not enough for becoming an effective manager. |   |

(*Contd.*)

| Characteristics/ Contributions | Limitations | Illustration |
|---|---|---|
| McKINSEY's 7-S FRAMEWORK | | |
| The seven S's are (1) strategy, (2) structure, (3) systems, (4) style, (5) staff, (6) shared values, and (7) skills. | Although this experienced consulting firm uses a framework similar to that found useful by Koontz and colleagues since 1955 and confirms its practicality, the terms used are not precise and topics are not discussed in depth. |   |
| TOTAL QUALITY MANAGEMENT APPROACH | | |
| Focuses on providing dependable, satisfying products and services (Deming) or products or services that are fit for use (Juran), as well as conforming to quality requirements (Crosby). The general concepts are continuous improvement, attention to details, teamwork, and quality education. | No complete agreement on what total quality management is. |   |
| MANAGEMENT PROCESS OR OPERATIONAL APPROACH | | |
| Draws together concepts, principles, techniques, and knowledge from other fields and managerial approaches. The attempt is to develop science and theory with practical application. Distinguishes between managerial and nonmanagerial knowledge. Develops a classification system built around the managerial functions of planning, organizing, staffing, leading, and controlling. | Does not, as some authors do, identify representing or coordination as a separate function. Coordination, for example, is the essence of managership and is the purpose of managing. |   |

After systematically studying the activities of five CEOs in a variety of organizations, Mintzberg came to the conclusion that executives do not perform the classical managerial functions of planning, organizing, commanding, coordinating, and controlling. Instead, they engage in a variety of other activities. From his research

and the research of others who had studied what managers actually did, Mintzberg concluded that managers really fill a series of ten roles:

**Interpersonal roles**

1. The figurehead role (performing ceremonial and social duties as the organization's representative)
2. The leader role
3. The liaison role (particularly with outsiders)

**Informational roles**

4. The recipient role (receiving information about the operation of an enterprise)
5. The disseminator role (passing information to subordinates)
6. The spokesperson role (transmitting information to those outside the organization)

**Decision roles**

7. The entrepreneurial role
8. The disturbance-handler role
9. The resource-allocator role
10. The negotiator role (dealing with various persons and groups of persons)

Mintzberg's approach has also been criticized. In the first place, the sample of five CEOs used in his research is far too small to support so sweeping a conclusion. In the second place, in analyzing the actual activities of managers—from CEOs to supervisors—any researcher must realize that all managers do some work that is not purely managerial; one would expect even presidents of large companies to spend some of their time in public and stockholder relations, in fund-raising, and perhaps in dealer relations, marketing, and so on. In the third place, many of the activities Mintzberg found are in fact evidence of planning, organizing, staffing, leading, and controlling. For example, what is resource allocation but planning? The entrepreneurial role is certainly an element of planning. And the interpersonal roles are mainly instances of leading. In addition, the informational roles can be fitted into a number of functional areas.

Nevertheless, looking at what managers really do can have considerable value. In analyzing activities, an effective manager might wish to ascertain how activities and techniques fall into the various fields of knowledge reflected by the basic functions of managers. However, the roles Mintzberg identified appear to be incomplete. Where does one find such unquestionably important managerial activities as structuring an organization, selecting and appraising managers, and determining major strategies? Omissions such as these make one wonder whether the executives in his sample were really effective managers. They certainly raise a serious question as to whether the managerial roles approach, at least as put forth here, is an adequate one on which to base a practical, operational theory of management.

## The Leadership Approach

The renewed interest in leadership necessitates a thorough discussion of this topic as shown in the title of this book: Essentials of Management—An International and Leadership Perspective. In this book, the term *leadership* generally refers to the

characteristics of individuals. In addition, however, the leadership perspective inserts also refer to enterprises that have a leading position in their respective industry or environment in case of not-for-profit organization. The leading position is often attained by the top executive or executives of the enterprise.

### The Management Process or Operational Approach

The **management process or operational approach** draws together the pertinent knowledge of management by relating it to the managerial job.

The process or operational approach to management theory and science draws together the pertinent knowledge of management by relating it to the managerial job—what leaders do. Like other operational sciences, it tries to integrate the concepts, principles, and techniques that underlie the task of managing.

This approach recognizes that there is a central core of knowledge about managing that is pertinent only to the field of management. Such matters as line and staff, departmentation, managerial appraisal, and various managerial control techniques involve concepts and theories found only in situations involving managers. In addition, this approach draws on and absorbs knowledge from other fields, including systems theory, quality and reengineering concepts, decision theory, theories of motivation and leadership, individual and group behavior, social systems, and cooperation and communications, as well as the application of mathematical analyses and concepts.

The nature of this approach can be seen in Figure 1.4. As this diagram shows, the management process, or operational school recognizes the existence of a central core of science and theory peculiar to managing and also draws important contributions from various other schools and approaches. In addition, the management process theorist is interested not in all the important knowledge in these various fields but only in that which is deemed most useful and relevant to managing.

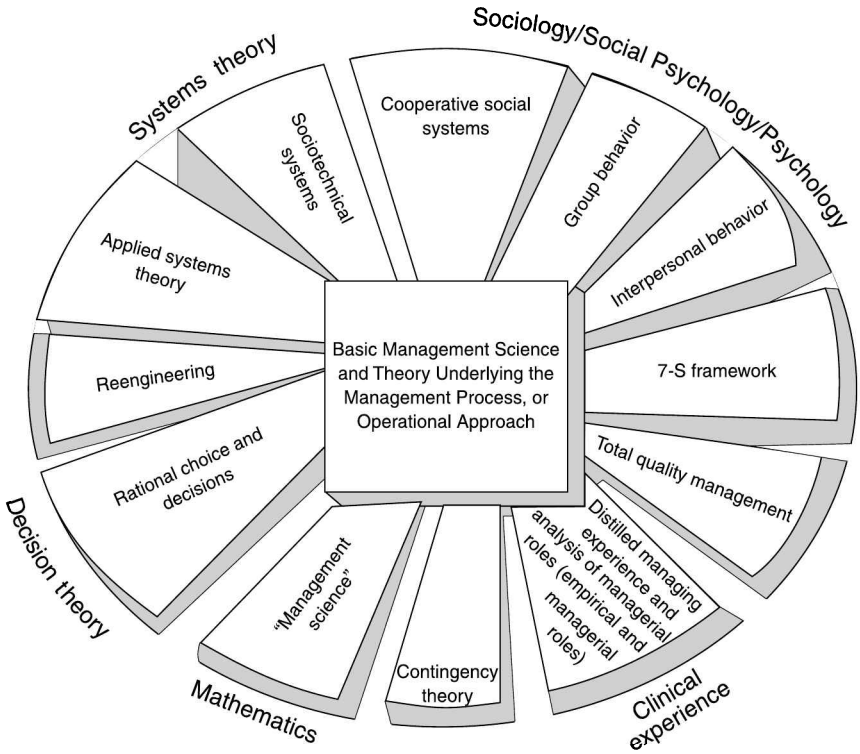
## THE SYSTEMS APPROACH TO THE MANAGEMENT PROCESS

An organized enterprise does not, of course, exist in a vacuum. Rather, it is dependent on its external environment; it is a part of larger systems, such as the industry to which it belongs, the economic system, and society. Thus, the enterprise receives inputs, transforms them, and exports the outputs to the environment, as shown by the very basic model in Figure 1.5. However, this simple model needs to be expanded and developed into a model of process, or operational management that indicates how the various inputs are transformed through the managerial functions of planning, organizing, staffing, leading, and controlling, as shown in Figure 1.6. When Peter Senge, the author of *The Fifth Discipline: The Art and Practice of the Learning Organization*, was asked what is the most important issue faced by domestic and international businesses today, he said, "I would say the system of management."[25] This book is about the systems approach to the management process. Not only is the concern about the internal functioning of the enterprise, but it must include the interactions between the enterprise and its external environment.

**Figure 1.3**

**The Management Process or Operational Approach.**

**Management theory and science as a system draw on other areas of organized knowledge. The figure shows how operational management theory and science, here enclosed in the circle, have a core of basic science and theory and draw from other fields of knowledge pertinent to understanding management. Basic management is thus, in part, an eclectic science and theory.**



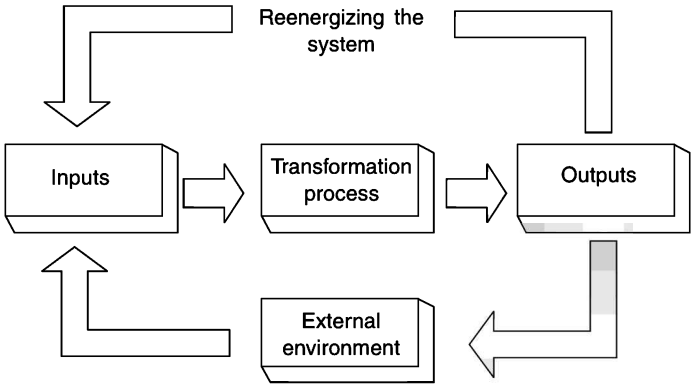

## Inputs and Claimants*

**Inputs** People, capital, managerial skills, technical knowledge, and skills.

The inputs from the external environment (see Figure 1.6) may include people, capital, managerial skills, as well as technical knowledge and skills. In addition, various claimants make demands on the enterprise. For example, employees want higher pay, more benefits, and job security. Consumers demand safe and reliable products at reasonable prices. Suppliers want assurance that their products will be bought. Stockholders want not only a high return on their investment but also security for their money. Federal, state, and local governments depend on taxes paid by the enterprise, but they also expect the enterprise to comply with their laws. Similarly, the community demands that enterprises be "good citizens," providing the maximum number of jobs with a minimum of pollution. Other claimants to the enterprise may include financial institutions and labor unions; even competitors have a legitimate

*Claimants may also be called stakeholders

**Figure 1.3**
**Input–Output Model.**




claim for fair play. It is clear that many of these claims are incongruent, and it is the manager's job to integrate the legitimate objectives of the claimants. This may need to be done through compromises, trade-offs, and denial of the manager's own ego.

## The Managerial Transformation Process

The task of managers is to transform the inputs, in an effective and efficient manner, into outputs.

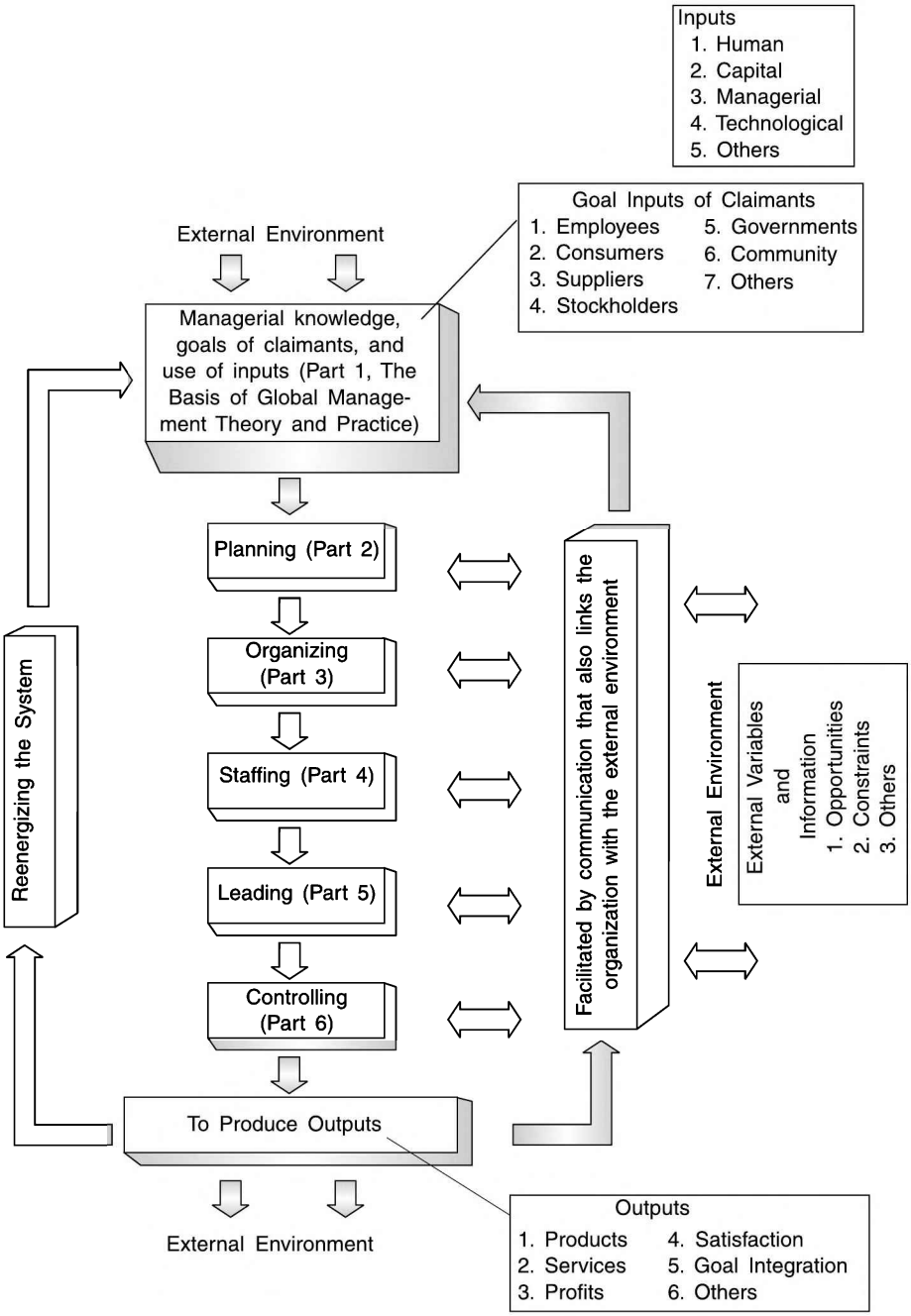
It is the task of managers to transform the inputs, in an effective and efficient manner, into outputs. Of course, the transformation process can be viewed from different perspectives. Thus, one can focus on such diverse enterprise functions as finance, production, personnel, and marketing. Writers on management look at the transformation process in terms of their particular approaches to management. Specifically, writers belonging to the human behavior school focus on interpersonal relationships, social systems theorists analyze the transformation by concentrating on social interactions, and those advocating decision theory see the transformation as sets of decisions. However, the most comprehensive and useful approach for discussing the job of managers is to use the managerial functions of planning, organizing, staffing, leading, and controlling as a framework for organizing managerial knowledge. Therefore, this is the approach used as the framework of this book (see Figure 1.6).

## The Communication System

Communication is essential to all phases of the managerial process for two reasons. First, it integrates the managerial functions. For example, the objectives set in planning are communicated so that the appropriate organization structure can be devised. Communication is essential in the selection, appraisal, and training of managers to fill the roles in this structure. Similarly, effective leadership and the creation of an environment conducive to motivation depend on communication. Moreover, it is through communication that one determines whether events and performance conform to plans. Thus, it is communication that makes managing possible.

**Figure 1.6**

**Systems Approach to Management.**



The second purpose of the communication system is to link the enterprise with its external environment, where many of the claimants are. For example, one should never forget that customers, who are the reason for the existence of virtually all businesses, are outside a company. It is through the communication system that the needs of customers are identified; this knowledge enables the firm to provide products and services at a profit. Similarly, it is through an effective communication system that the organization becomes aware of competition and other potential threats and constraining factors.

## External Variables

Effective managers will regularly scan the external environment. While it is true that managers may have little or no power to change the external environment, they have no alternative but to respond to it. The forces acting in the external environment are discussed in various chapters, especially in Chapters 2, 3, and 5.

## Outputs

**Outputs** Products, services, profits, satisfaction, and integration of the goals of claimants to the enterprise.

It is the task of managers to secure and utilize inputs to the enterprise to transform them through the managerial functions—with due consideration for external variables—into outputs. Although the kinds of outputs will vary with the enterprise, they usually include many of the following: products, services, profits, satisfaction, and integration of the goals of various claimants to the enterprise. Most of these outputs require no elaboration, and only the last two will be discussed.

The organization must indeed provide many "satisfactions" if it hopes to retain and elicit contributions from its members. It must contribute to the satisfaction not only of basic material needs (e.g., employees' needs to earn money for food and shelter or to have job security) but also of the needs for affiliation, acceptance, esteem, and perhaps even self-actualization so that one can realize one's potential at the workplace.

Another output is goal integration. As noted earlier, the different claimants to the enterprise have very divergent—and often directly opposing—objectives. It is the task of managers to resolve conflicts and integrate these aims.

## Reenergizing the System

Finally, it is important to note that, in the systems model of the management process, some of the outputs become inputs again. Thus, the satisfaction and new knowledge or skills of employees become important human inputs. Similarly, profits, the surplus of income over costs, are reinvested in cash and capital goods, such as machinery, equipment, buildings, and inventory. You will see shortly that the model shown in Figure 1.6 will serve as a framework in this book for organizing managerial knowledge. But let us first look closer at the managerial functions.

# THE FUNCTIONS OF MANAGERS

The functions of managers provide a useful structure for organizing management knowledge (see the central part of Figure 1.6). There have been no new ideas, research findings, or techniques that cannot readily be placed in the classifications of planning, organizing, staffing, leading, and controlling.

## Planning

**Planning** Selecting missions and objectives as well as the actions to achieve them, which require decision-making.

**Planning** involves selecting missions and objectives as well as the actions to achieve them; it requires decision-making, which is, choosing future courses of action from among alternatives. As Chapter 4 will show, there are various types of plans, ranging from overall purposes and objectives to the most detailed actions to be taken, such as ordering a special stainless steel bolt for an instrument or hiring and training workers for an assembly line. No real plan exists until a decision—a commitment of human or material resources—has been made. Before a decision is made, all that exists is a planning study, an analysis, or a proposal; there is no real plan. The various aspects of planning are discussed in Part 2 of this book.

## Organizing

People working together in groups to achieve some goal must have roles to play, much like the parts actors fill in a drama, whether these roles are the ones they develop themselves, are accidental or haphazard, or are defined and structured by someone who wants to make sure that they contribute in a specific way to group effort. The concept of a role implies that what people do has a definite purpose or objective; they know how their job objective fits into the group effort, and they have the necessary authority, tools, and information to accomplish the task. This can be seen in as simple a group effort as setting up camp on a fishing expedition. Everyone could do anything he or she wants to do, but activity would almost certainly be more effective and certain tasks would be less likely to be left undone if one or two persons were given the job of gathering firewood, some the assignment of getting water, others the task of starting a fire, yet others the job of cooking, and so on.`

**Organizing** Establishing an intentional structure of roles for people to fill an organization.

**Organizing**, then, is that part of managing which involves establishing an intentional structure of roles for people to fill in an organization. It is intentional in the sense of making sure that all the tasks necessary to accomplish goals are assigned and, it is hoped, assigned to people who can do them best.

The purpose of an organization structure is to help create an environment for human performance. It is then a management tool and not an end in and of itself. Although the structure must define the tasks to be done, the roles so established must also be designed in light of the abilities and motivations of the people available.

Designing an effective organization structure is not an easy managerial task. Many problems are encountered in making structures fit situations, including both defining the kinds of jobs that must be done and finding the people to do them. These problems and the essential theories, principles, and techniques of handling them are the subjects of Part 3.

## Staffing

**Staffing** Filling, and keeping filled, the positions in the organization structure.

**Staffing** involves filling, and keeping filled, the positions in the organization structure. This is done by identifying workforce requirements; inventorying the people available; and recruiting, selecting, placing, promoting, appraising, planning the careers of, compensating, and training or otherwise developing both candidates and current jobholders so that tasks are accomplished effectively and efficiently. This subject is dealt with in Part 4.

## Leading

**Leading** Influencing people so that they will contribute to organizational and group goals.

**Leading** is influencing people so that they will contribute to organizational and group goals; it has to do predominantly with the interpersonal aspect of managing. All managers would agree that their most important problems arise from people—their desires and attitudes as well as their behavior as individuals and in groups—and that effective managers also need to be effective leaders. Since leadership implies followership and people tend to follow those who offer means of satisfying their own needs, wishes, and desires, it is understandable that leading involves motivation, leadership styles and approaches, and communication. The essentials of these subjects are dealt with in Part 5.

## Controlling

**Controlling** Measuring and correcting individual and organizational performance to ensure that events conform to plans.

**Controlling** is measuring and correcting individual and organizational performance to ensure that events conform to plans. It involves measuring performance against goals and plans, showing where deviations from standards exist, and helping to correct deviations from standards. In short, controlling facilitates the accomplishment of plans. Although planning must precede controlling, plans are not self-achieving. Plans guide managers in the use of resources to accomplish specific goals; then activities are checked to determine whether they conform to the plans.

Control activities generally relate to the measurement of achievement. Some means of controlling, like the budget for expenses, inspection records, and the record of labor-hours lost, are generally familiar. Each of them measures, and each shows, whether plans are working out. If deviations persist, correction is indicated. But what is corrected? Activities, through persons. Nothing can be done about reducing scrap, for example, or buying according to specifications, or handling sales returns unless one knows who is responsible for these functions. Compelling events to conform to plans, means locating the persons who are responsible for results that differ from planned action and then taking the necessary steps to improve performance. Thus, outcomes are controlled by controlling what people do. This subject is treated in Part 6.

## Coordination, the Essence of Managership

Some authorities consider coordination to be a separate function of the manager. It seems more accurate, however, to regard it as the essence of managership, for

achieving harmony among individual efforts toward the accomplishment of group goals. Each of the managerial functions is an exercise contributing to coordination.

Even in the case of a church or a fraternal organization, individuals often interpret similar interests in different ways, and their efforts toward mutual goals do not automatically mesh with the efforts of others. It thus becomes the central task of the manager to reconcile differences in approach, timing, effort, or interest and to harmonize individual goals to contribute to organizational goals.

### Managers or Leaders—That is the Question

While some authors make a distinction between managers and leaders (with managers often depicted unfavorably), we suggest that good managers *have* to be good leaders. However, we maintain that good leaders also have to carry out effectively the managerial functions of planning, organizing, staffing, controlling and, of course, leading. Fred Luthans in his book chapter "Great Leaders: An Evidence-Based Approach" uses the term *leaders* and *managers* interchangeably. Moreover, he argues in that "this chapter on leadership styles, activities, and skills is also on management styles, activities, and skills,"[26] showing that managing and leading are closely intertwined. Our book, therefore, is about management with special attention given to the leadership aspects of managing.

## THE SYSTEMS MODEL OF MANAGEMENT AND THE ORGANIZATION OF THIS BOOK

The model of the systems approach to management is also the foundation for organizing managerial knowledge. Note that in Figure 1.6 the numbers shown in the model correspond to the parts of this book. Part 1 covers the basis of management and the interactions between the organization and its environment. This part cuts across all managerial functions. It deals with basic managerial knowledge, such as theory, science, and practice. It also discusses the evolution of management and the various approaches to management. Since organizations are open systems, they interact with the external environment: domestic and international.

The figure also shows that Part 2 deals with the various aspects of planning (Chapters 4 to 6). Part 3 is concerned with organizing (Chapters 7 to 10), while Part 4 deals with staffing (Chapters 11 to 13), Part 5 with leading (Chapters 14 to 17), and Part 6 with controlling (Chapters 18 to 20).

This book has a global perspective of management. Increasingly, organizations operate in the global market. Therefore, comparative and international management aspects are discussed not only in Chapter 3 but also throughout the book.

The model shown in Figure 1.6 is repeated at the beginning of Parts 2 to 6, but with the appropriate part highlighted. This feature of an integrative model shows the relationships of the topics in this book.

## SUMMARY

Management is the process of designing and maintaining an environment for efficiently accomplishing selected aims. Managers carry out the functions of planning, organizing, staffing, leading, and controlling. Managing is an essential activity at all organizational levels; however, the managerial skills required vary with the organizational level. The goal of all managers is to create a surplus. Enterprises must take advantage of the 21st century trends in information technology, globalization, and entrepreneurship. They must also focus on productivity, that is, to achieve a favorable output–input ratio within a specific time period with due consideration for quality. Productivity implies effectiveness (achieving of objectives) and efficiency (using the least amount of resources). Managing as practice is an art; organized knowledge about management is a science.

Many writers and practitioners have contributed to the development of management thought. The major contributors and their works are shown in Table 1.1. Many theories about management have been proposed, and each contributes something to our knowledge of what managers do. The characteristics and contributions as well as the limitations of the various approaches to management are summarized in Figure 1.3. The management process (or operational) approach draws from other theories of management and integrates them into a total system of managing.

The organization is an open system that operates within and interacts with the environment. The systems approach to management includes inputs from the external environment and from claimants, the transformation process, the communication system, external factors, outputs, and a way to reenergize the system. The transformation process consists of the managerial functions, which also provide the framework for organizing knowledge in this book. Throughout the book, but especially in Chapter 3, international aspects of managing are emphasized.

## KEY IDEAS AND CONCEPTS FOR REVIEW

- ✔ Management
- ✔ Managerial functions
- ✔ Managerial skills in the organizational hierarchy
- ✔ The goal of all managers
- ✔ Characteristics of excellent and most admired companies
- ✔ Three major trends: Advances in technology, globalization, and entrepreneurship
- ✔ Productivity, effectiveness, and efficiency
- ✔ Managing: science or art?
- ✔ Major contributors to management thought
- ✔ Contributors to scientific management
- ✔ Fayol's operational management theory
- ✔ Mayo and Roethlisberger
- ✔ Recent contributors to management thought
- ✔ Management theory jungle
- ✔ Managerial roles approach
- ✔ Management process or operational approach
- ✔ Managers or Leaders?
- ✔ Systems approach to the management process
- ✔ Five managerial functions

## FOR DISCUSSION

1. How would you define management? Does your definition differ from the one offered in this book? Explain.
2. What are the managerial functions?
3. How do the required managerial skills differ in the organizational hierarchy?
4. In what fundamental way are the basic goals of all managers at all levels and in all kinds of enterprises the same?
5. What are some of the characteristics of excellent companies (according to Peters and Waterman)? Do the companies you know have these characteristics?
6. How do advances in technologies, globalization, and entrepreneurship affect businesses?
7. What are the differences between productivity, effectiveness, and efficiency?
8. Is managing a science or an art? Could the same explanation apply to engineering or accounting?
9. Why has Frederick Taylor been called the father of scientific management and Henri Fayol the father of modern management theory?
10. What is meant by the term *management theory jungle*?
11. Identify the various approaches to management analysis. Discuss their characteristics and contributions as well as their limitations.
12. What do you consider ethical and unethical behavior? Give examples.
13. Is there a difference between managers and leaders?

## EXERCISES/ACTION STEPS

1. Interview two local business managers and ask them how they learned about managing. Ask what kind of books they might have read on management (e.g., textbooks or popular books). Here are examples of management books: Gary Hamel and C. K. Prahalad, *Competing for the Future*; Michael Hammer and James Champy, *Reengineering the Corporation*; Charles Handy, *The Age of Paradox*; John P. Kotter, *The New Rules: How to Succeed in Today's Post-Corporate World*; Peter M. Senge, *The Fifth Discipline*; and W. Chan Kim and Renee Mauborgne, *Blue Ocean Strategy.* Probe to what extent these books have helped them to manage. You may also find it interesting to read one of the best-selling books on management and mention it in the class discussion.
2. Interview two public administrators and ask them how their job differs from that of business managers. How do they know how well their department, agency, or organization is performing since profit is probably not one of their criteria for measuring effectiveness and efficiency? Do they consider management an art or a science?

## INTERNET RESEARCH

1. Review three of the following websites for current topics of management: *www.businessweek.com*, *www.economist.com*, *www.fortune.com*, *www.forbes.com*, *www.industryweek.com*, *http://public.wsj.com/home.html*, *www.hbsp.harvard.edu/products/hbr/index.html*,

*http://mitsloan.mit.edu/smr/index.html*. If you are interested in Indian issues, see *http://www.businessworld.in*.

2. Read the cover stories of *Business Week*, *Fortune*, and *The Economist* on the Web (*www.businessweek.com*, *www.fortune.com*, *www.economist.com*) and identify any section in this book that relates to these stories.

## International Case Apple's iPad 2: The Tablet to Beat?[27]

The forerunner to the iPad tablet computer was first introduced by Apple Inc. in 1993 as the Newton Message Pad. Other companies also introduced tablets, often based on the IBM-PC or other architectures. For example, Microsoft introduced the tablet PC in the year 2000. But the tablet computer did not surge in popularity until the introduction of the Apple's iPad in April 2010 and the second generation, the iPad 2, in March 2011. Some industry analysts criticized the functionality of the iPad, contending that as it was neither a computer nor a smart phone; it would not be needed. However, these critics were silenced by the sales success. For example, the first iPad sold 3 million devices during the first 80 days. Furthermore, the initial demand for the iPad 2 resulted in very long lines at the Apple stores amid shortages of the popular device.

Initially, the iPad was developed as a platform especially for audio and visual media such as music, movies, games, and reading books, periodicals, newspapers and other web content. The iPad shares the operating system with Apple's iPod Touch and the iPhone and can easily integrate with those devices.

The iPad is different from the laptop as it is operated by touch, which means that it has no physical keyboard, but has an on-screen keyboard. Neither does the iPad use a mouse. The various models are connected through Wi-Fi and some even through 3G wireless connection. All the models can be synced with iTunes through a USB cable connected to a personal computer. Therefore, iTunes is used as an interface, connecting not only the iPad, but also the iPod Touch, and the iPhone. Apple's iTunes store allows downloading different kinds of contents, but especially music and videos. iTunes then is an important part of Apple's successful strategy for mobile devices.

The original iPad and other Apple products have been a great success. By March 2011:

- Millions of iBooks were downloaded
- About 15 million iPads were sold in 2010 and 24 million are expected to sell in 2011[28]
- In early 2011, iTunes has more than 3,50,000 apps with about 65,000 apps specifically designed for the iPad. The applications are not only for listening music and watching videos, but are used in various ways in schools, hospitals, and businesses which means that they impact people's lives in many ways
- Apple retail stores contributed to Apple's success as they provided a place for potential customers eager to learn about Apple's new products with knowledgeable and friendly store associates
- Apple products are game changers; they are used in everyday's activities
- Steve Jobs called 2010 the year of the iPad and 2011 the year of iPad 2.
- However, it is with great sorrow that Steve Jobs passed away in 2011

The second iPad generation, the iPad 2, appears to continue or exceed its success of the first model.

So what are some of the new features of iPad 2? In a nutshell:[29]

- The device is very thin; in fact, it is 33 percent thinner (8.8 millimeter) than the original iPad and weighs only 1.3 pounds
- It has rear and front facing cameras
- It is driven by a fast dual-core A5 processor
- It has a battery life of ten hours (as the original iPad), but at the same time, the new one is lighter and slimmer
- The screen is protected by a very slim, elegant, magnetically attached cover in ten different colors
- It also has a gyroscope as the one found in Apple's iPhone and iPod Touch
- The iPad is available in two colors (black and white) and can be connected through AT&T and Verizon to 3G
- The price is very competitive in America ranging from $499 for the 16 GB to $829 for 64 GB with 3G connection
- The iPad 2 was introduced on March 11, 2011 in the United States and shortly afterwards in 26 countries

Despite its many strong points, the iPad has what many consider weaknesses. For example, the iPad does NOT have:

- A fast 4G connection
- An SD card slot
- A USB connection
- A Flash port
- The best camera possible

There are many applications available for the iPad and many more are to come. Thousands of applications can be used for various business tasks. Colleagues can collaborate on creating, sharing, and analyzing information, or work on a shared business presentation. The iPad is, for example, used in the Ottawa Hospital, is replacing the paper medical charts.[30] The doctors can carry the patients' medical records on the iPad in their pockets.

In education, there are apps for learning many subjects.[31] In iTunes U, students can listen to lectures, watch videos by distinguished professors from universities such as UC Berkeley, Yale, Stanford or even presentations from universities abroad such as from the UK at Oxford and Cambridge, the Beijing Open University, and the University of Tokyo. Books can be downloaded from Apple's iBooks, Amazon's Kindle, or Project Gutenberg. One company, Inkling, has arrangements with McGraw-Hill, the publisher of this book, to link the iPad to textbooks.[32] These are just a few examples of the many applications. In short, iPad can change the way we work.

The Year 2011 may be the "Year of the Tablet Computers."[33] Despite iPad's success, Apple has also many competitors such as:

- Motorola's Xoom
- Samsung's Galaxy Tab 10
- RIM's BlackBerry PlayBook
- Dell's Streak 7 Wi-Fi Table
- LG's OptimusPad
- HTC's upcoming tables

- Acer's Iconia Tab A500
- HP's Touch Pad
- Amazon's Kindle that is dedicated for book reading[34]

The question remains: Is Apple's iPad 2: The Tablet to Beat?

**Questions**

1. Why has Apple been so successful? What are Apple's strengths?
2. What are the features of the Apple iPad (and especially iPad 2) that make these tablets so successful?
3. What are the weaknesses of the iPad and what features should be added?
4. How does the iPad 2 compete with the Netbooks? What are the distinguishing features of the iPad 2 and typical netbooks?
5. What are the current applications of the iPad and what are some possible future apps?

## LEGENDS

**Frederick W. Taylor**
1856–1915
(Historical Pictures Service, Chicago)

**Henri Fayol**
1841–1925
(Ronald T. Greenwood)

**Elton Mayo**
1880–1949
(Baker Library, Harvard University Graduate School of Business Administration)

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3. "The Best Managers," *Business Week,* January 19, 2009, pp. 40-41.
4. Note that this approach is similar to concepts as discussed in the book *Blue Ocean Strategy* by W. Chan Kim and Renee Mauborgne which will be discussed later in this book.
5. Thomas J. Peters and Robert H. Waterman. Jr., *In Search of Excellence*, New York, Harper & Row, 1982.
6. "Who's Excellent Now?" *Business Week*, November 5, 1984, pp. 76–88. See also Michael A. Hitt and R. Duane Ireland, "Peters and Waterman Revisited: The Unending Quest for Excellence," *Academy of Management Executive*, May 1987, pp. 91–98.
7. Peters and Waterman, *In Search of Excellence*. For excellent discussions with the authors conducted by William C. Bogner some 20 years after the publication of their book (as well

as their other books), see the February 2002 issue of *Academy of Management Executive* for "Introduction: A Bright Signal in a Dark Time," pp. 38–39; "Tom Peters on the Real World of Business," pp. 40–44; and "Robert H. Waterman, Jr., on Being Smart and Lucky," pp. 45–50. There are also two valuable commentaries on *In Search of Excellence* in the same issue of the journal: Les Misik, "The Attributes of Excellence: The Importance of Doing," pp. 51–52; John W. Newstrom, "In Search of Excellence: Its Importance and Effects," pp. *Academy of Management Executive,* February 2002, pp. 53–56.

8. Bruce Einhorn in Hong Kong, "Hanging Tough in Asia" *Business Week,* September 15, 2008, p.66.
9. "China's Alibaba Expands to India, Japan," *http://www.businessweek.com/globalbiz/content/sep2008/gb2008095_369479.htm?campaign_id=rss_as*, accessed November 15, 2011.
10. See, for example, the "Technology Quarterly" in *The Economist*, December 2, 2006 that discusses, for example, trends in the impact of technology on society, computing, robotics, communications, electronics, news media, innovation, biometrics and security, transportation, and other areas; see also *Bloomberg Business Week Online* at *http://www.businessweek.com/ebiz* accessed November 15, 2011; Mobile Computing *http://searchmobilecomputing.techtarget.com/sDefinition/0,sid40_gci214590,00.html,* accessed November 15, 2011.
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# 2 Management and Society: The External Environment, Social Responsibility, and Ethics

## Chapter Objectives

After studying this chapter, you should be able to:

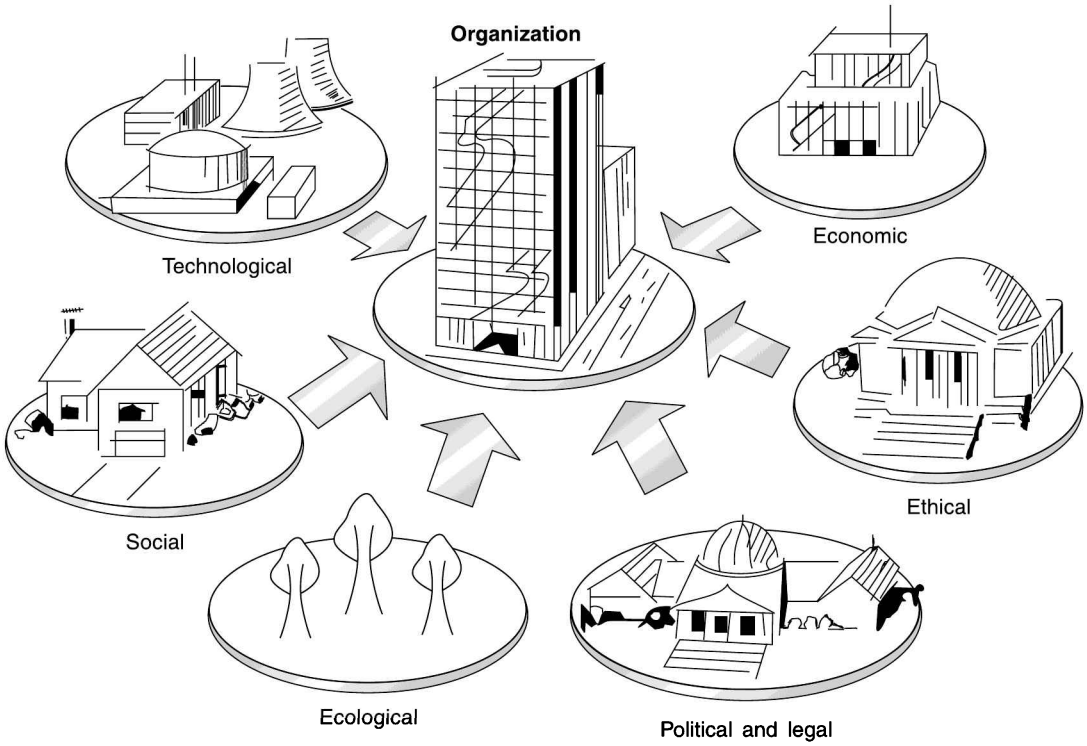
- Describe the nature of the pluralistic society and selected environments
- Explain the social responsibility of managers and the arguments for and against the social involvement of business
- Understand the nature and importance of ethics in managing and ways to institutionalize ethics and raise ethical standards
- Recognize that some ethical standards vary in different societies
- Realize that trust is the basis for human interaction

Every time managers plan, they take into account the needs and desires of members of society outside the organization, as well as the needs for material and human resources, technology, and other requirements in the external environment. They do likewise to some degree with almost every other kind of managerial activity.

All managers, whether they operate in a business, a government agency, a church, a charitable foundation, or a university, must, in varying degrees, take into account the elements and forces of their external environment. While they may be able to do little or nothing to change these forces, they have no alternative but to respond to them. They must identify, evaluate, and react to the forces outside the enterprise that may affect its operation. The impact of the external environment on the organization is illustrated in Figure 2.1. The constraining influences of external factors on the enterprise are even more crucial in international management (a fact to be discussed in Chapter 3).

**Figure 1.6**

**The Organization and its External Environment.**




This chapter deals with the impact of the external environment on the organization—with a focus on the technological and ecological environment—and the relationships between business and the society in which it operates. First, the focus is on the nature of the pluralistic society. Then the discussion expands to the topics of social responsibility and ethical behavior.

**LEADERSHIP PERSPECTIVE**

## How Do Companies Provide Service in Times of an Economic Crisis?[1]

Figure 2.1 shows that the economic environment affects organizations. At time of financial crisis, some companies try reduce costs through layoffs and other measures. Yet, a greater focus on better quality and giving better customer service may be called for. Easier said than done? Yet, companies that have done so may earn profit. In fact, the ranking of Customer Service Champs showed that treating

customers better might pay off well. While trying to reduce back-office expenses, firms may want to maintain front-line personnel, sometimes by using inexpensive technology. For example, BMW dealerships provided their customers Wi-Fi services to use the time while waiting for their vehicles to be serviced. This enhanced customer service also resulted in lower costs as fewer customers took advantage of free loaner cars, a costly benefit. ■■

## OPERATING IN A PLURALISTIC SOCIETY

**Pluralistic society** A society where many organized groups represent various interests.

Managers operate in a **pluralistic society**, in which many organized groups represent various interests. Each group has an impact on other groups, but no one group exerts an inordinate amount of power. Many groups exert some power over business. As explained in Chapter 1, there are many stakeholders or claimants on the organization, and they have divergent goals. It is the task of the manager to integrate their aims.

Working within a pluralistic society has several implications for business. First, various groups such as environmental groups, keep the business power in balance. Second, business interests can be expressed by joining groups such as the Chamber of Commerce. Third, business can participate in projects with other responsible groups for the purpose of bettering society; an example is working toward the renewal of inner cities. Fourth, in a pluralistic society, there can be conflict as well as agreement among groups. Finally, in such a society, one group is quite aware of what other groups are doing.

## THE TECHNOLOGICAL ENVIRONMENT

**Technology** The sum total of the knowledge we have of ways to do things.

One of the most pervasive factors in the environment is technology. The term **technology** refers to the sum total of the knowledge we have of ways to do things. It includes inventions and techniques, and it includes the vast store of organized knowledge about everything from aerodynamics to zoology. But its main influence is on ways of doing things, on how we design, produce, distribute, and sell goods and services.

**LEADERSHIP PERSPECTIVE**

### The Third Wave: The Knowledge Age[2]

The first-wave economy was based on land and farm labor. The second wave centered on machines and large industries. The third-wave economy is the knowledge age, which encompasses data, images, symbols, culture, ideology, values, and information. Being at the frontiers of the new technologies, society must rethink the way it structures itself and how it strikes a balance between freedom and restrictions (e.g., how to manage or control the massive amount of information available

on the Internet). Cyberspace is a bio-electronic environment that exists wherever one can find telephone and coaxial cables, fiber-optic lines, or electromagnetic waves. It requires a rethinking of centralization versus decentralization, organizational hierarchy versus empowerment, and vertical versus horizontal organization structures, just to mention a few. ■■

## THE ECOLOGICAL ENVIRONMENT

**Ecology** The relationship of people and other living things with their environment.

Managers must take into account the ecological factors in their decision-making. By **ecology** we mean the relationship of people and other living things with their environment, such as soil, water, and air. Land, water, and air pollution is of great concern to all people. Land may be polluted by industrial waste such as packaging. Water pollution may be caused, for example, by hazardous waste and sewage. Air pollution can be caused by a variety of sources, such as acid rain, vehicle exhaust fumes, and carcinogens from manufacturing processes.

A variety of legislation has been passed dealing with solid waste, water, and air pollution. Managers must be keenly aware of these laws and regulations and must incorporate ecological concerns into their decision-making.

**INTERNATIONAL PERSPECTIVE**

### The Bhopal Plant in India[3]

www.bhopal.net

In December 1984, lethal vapors from Union Carbide's pesticide plant in India killed over 2,000 people and injured 30,000 to 40,000 others. It was the worst industrial disaster, which was at first attributed to failed safety devices and procedures. A subsequent investigation theorized that the disaster was due to sabotage by a disgruntled employee.

In 1975, Carbide obtained permission from the Ministry of Industry in New Delhi to build a plant for producing methyl isocyanate. After 1982, the plant was turned over to Indian personnel because of governmental pressure to make Indian industry self-sufficient. Safety inspections became the responsibility of UCIL, the Indian subsidiary of Union Carbide, which maintained majority ownership of UCIL. After the accident, Warren Anderson, Carbide's chairman, accepted the moral responsibility for the tragedy. Various theories developed about the real cause of the accident.

American experts and relief were sent to India, followed by American lawyers who wanted to represent the victims. After many arguments, the suit was tried in India, where U.S. lawyers were not allowed to represent the victims. In 1989, the lawsuit was settled in which Union Carbide agreed to pay $470 million.

Still, the issue remains as to who should be held accountable? Top management at Union Carbide? Managers at UCIL? Operators responsible for the methyl isocyanate unit? The Indian government issuing the permit? Indeed these are difficult questions for multinational corporations and governments. ■■

In order to protect the environment, European countries developed the ISO 14001 standard to assure that company policies address a variety of public concerns, including pollution prevention and compliance with relevant laws and regulations. Since the adoption of ISO 14001 in 1996, some 10,000 companies had registered by the year 2000. Although the standard had a slow start in the United States, it received a boost when Ford Motor Company certified all its facilities around the world as conforming to ISO 14001. [4]Other companies such as General Motors, IBM, and Xerox followed. The standard was valuable to Ford for reducing water consumption, disposed paint sludge, and disposable packing materials.

www.gm.com

More recently, ecological concerns have focused on climate change and global warming. Global warming refers to the increase in temperature of the Earth's atmosphere and oceans that is believed to be caused by the human creation of excess carbon dioxide. The increase in temperature may lead to rising sea levels and an increase in extreme weather.[5] Managers must now consider how their products and production processes impact the earth's climate over the long term and seek ways to minimize any negative consequence of their firms' activities.

**LEADERSHIP PERSPECTIVE**

## The Greening of GM[6]

"Green and fuel-efficient" are the key words for success in the car market. General Motors (GM) is late, perhaps too late, in this game. Toyota started working on hybrids in the mid-1990s.

Chairman Richard Wagoner Jr. (who has a finance background) seemed to have seen the light around 2005. Oil prices got out of control, global warming became an increasing concern, and fuel economy requirements all driving GM toward change. Actually, GM worked on an experimental electric car, the EV1, several years earlier. This idea was killed and superseded the profitable gas-guzzling SUVs.

In the middle of 2000, it became clear—go green or die. GM opted for the former with a revolutionary electric car: the Chevrolet Volt. The goal is to go green, go 40 miles by electric power before the gasoline engine kicks in, and get some 100 miles per gallon. All this is to be achieved by 2010. Will it work? That is the big question because of a variety of factors. It is costly and may increase the cost by $10,000 per vehicle; it is risky because it is based on new unproven technology; it is questionable whether the lithium batteries will be available for mass production; it is also not clear if the customers will buy a $39,000 to $45,000 car because

other alternatives may be available. Most rival car companies are prepared to offer fuel-efficient, low-carbon cars. Toyota has already several hybrids in the market with the Prius being the most prominent one. Honda bets its future on fuel-efficient clean diesel engines. Nissan, using the Toyota hybrid technology, will be another competitor. However, eventually, Nissan may opt for an approach similar to GM. In Europe, BMW and Mercedes also invested in hydro cars. Mercedes produced diesel cars since the mid-1930s and finally was able to make them clean.

With all that competition, can a financially stretched GM invest greatly into a risky technology with an uncertain prospect for success? What other choices does GM really have? These are some of the considerations Chairman and CEO have to consider. The strategy is at a critical point. ■■

## THE SOCIAL RESPONSIBILITY OF MANAGERS

In the early 1900s, the mission of business firms was exclusively economic. Today, partly owing to the interdependencies of many groups in our society, the social involvement of business has increased. As pointed out in the model of the systems approach to management in Chapter 1, there are many stakeholders or claimants to the organization. There is indeed a question as to what the social responsibility of business really is. Moreover, the question of social responsibility, originally associated with businesses, is now being posed with increasing frequency in regard to governments, universities, nonprofit foundations, charitable organizations, and even churches. Thus, we are talking about the social responsibility and social responsiveness of all organizations, although the focus of this discussion is on business. Society, awakened and vocal with respect to the urgency of social problems, is asking managers, particularly those at the top, what they are doing to discharge their social responsibilities and why they are not doing more.

### Social Responsibility and Social Responsiveness

**Corporate social responsibility** The serious consideration of the impact of the company's actions on society.

**Social responsiveness** The ability of a corporation to relate its operations and policies to the social environment in ways that is mutually beneficial to the company and to the society.

The concept of social responsibility is not new. Although the idea was already considered in the early part of the 20th century, it received a major impetus with the 1953 book *Social Responsibilities of the Businessman* by Howard R. Bowen, who suggested that businesses should consider the social implications of their decisions.[7] As might be expected, there is no complete agreement on the definition. In a survey of 439 executives, 68 percent of the managers who responded agreed with the following definition: **corporate social responsibility** is "seriously considering the impact of the company's actions on society."[8]

A concept that is newer, but very similar to social responsibility, is **social responsiveness**, which in simple terms means "the ability of a corporation to relate its operations and policies to the social environment in ways that are mutually beneficial to the company and to society." [9] Both definitions focus on corporations, but these concepts should be expanded to include enterprises other than businesses and to encompass relationships within an enterprise. The main difference between social responsibility and social responsiveness is that the latter implies actions and the "how" of enterprise responses. In this discussion, the terms will be used interchangeably.

LEADERSHIP PERSPECTIVE

### Social Responsiveness at Infosys

Sudha Murthy, the wife of the Chairman and CEO of Infosys, Narayana Murthy, is known for her philanthropic work through the Infosys Foundation. For example, she initiated that the government school in Karnataka provided library facilities and computers. She also teaches computer science and is a fiction writer. For her social work, she received the Raja-Lakshmi Award. She was also the first woman engineer at Telco which is now Tata Motors.[10]

In the meantime, more Indian women are accepted in the workplace.

## Arguments For and Against Business Involvement in Social Actions

Although there are arguments for business involvement in social activities, there are also arguments against it, as shown in Table 2.1.

Today, many businesses are involved in social actions. A good example is the Ben & Jerry ice cream company, which contributes to the conservation of the rainforest. The company also purchases nuts from tribes in the rainforest so that they do not rely on cutting trees for survival. A decision as to whether companies should extend their social involvement requires careful examination of the arguments for and against such actions. Certainly, society's expectations are changing, and the trend seems to be toward greater social responsiveness.

LEADERSHIP PERSPECTIVE

### Philanthropy in the Silicon Valley and Expanding Around the World according to Laura Arrillaga-Andreessen[11]

Laura Arrillaga-Andreessen, the wife of Marc Andreessen the Netscape Creator,[12] lives in the heart of Silicon Valley near San Francisco. She is surrounded by technology geeks which may have influenced her with the book *Giving 2.0: Transform*

**Table 2.1** Arguments For and Against Social Involvement of Business

*Arguments for social involvement of business*

1. Public needs have changed, leading to changed expectations. Business, it is suggested, received its charter from society and consequently has to respond to the needs of society.
2. The creation of a better social environment benefits both society and business. Society gains through better neighborhoods and employment opportunities; business benefits from a better community, since the community is the source of its workforce and the consumer of its products and services.
3. Social involvement discourages government regulation and intervention. The result is greater freedom and more flexibility in decision-making for business.
4. Business has a great deal of power that, it is reasoned, should be accompanied by an equal amount of responsibility.
5. Modern society is an interdependent system, and the internal activities of the enterprise have an impact on the external environment.
6. Social involvement may be in the interests of stockholders.
7. Problems can become profits. Items that may once have been considered waste (e.g., empty soft-drink cans) can be profitably used again.
8. Social involvement creates a favorable public image. As a result, the firm may attract customers, employees, and investors.
9. Business should try to solve the problems that other institutions have not been able to solve. After all, business has a history of coming up with novel ideas.
10. Business has the resources. Specifically, business should use the talents of its managers and specialists, as well as its capital resources, to solve some of society's problems.
11. It is better to prevent social problems through business involvement than to cure them. It may be easier to help the hard-core unemployed than to cope with social unrest.

*Arguments against social involvement of business*

1. The primary task of business is to maximize profit by focusing strictly on economic activities. Social involvement could reduce economic efficiency.
2. In the final analysis, society must pay for the social involvement of business through higher prices. Social involvement would create excessive costs for business, which cannot commit its resources to social action.`
3. Social involvement can create a weakened international balance-of-payment situation. The cost of social programs, the reasoning goes, would have to be added to the price of the product. Thus, socially involved companies selling in international markets would be at a disadvantage when competing with companies from other countries that do not have these social costs to bear.
4. Business has enough power, and additional social involvement would further increase its power and influence.
5. Businesspeople lack the social skills to deal with the problems of society. Their training and experience are with economic matters, and their skills may not be pertinent to social problems.
6. There is a lack of accountability of business to society. Unless accountability can be established, business should not get involved.
7. There is not full support for involvement in social actions. Consequently, disagreements among groups with different viewpoints will cause friction.

Based on a variety of sources, including William C. Frederick, Keith Davis, and James E. Post, *Business and Society*, 6th ed. (New York: McGraw-Hill, 1988), Chap. 2

*Your Giving and Our World*[13] in which she discusses the importance of giving: giving time, sharing experience and skills, giving money or helping people to access networks. Giving may be a $1 donation, or giving your time by volunteering for a cause about which you are passionate. This means first of all identifying your goal(s) of giving and then developing a strategy for sharing, a strategy that not only for local or national needs, but global causes as well, such as giving to those people affected by the 2010 floods in Pakistan, the 2004 Asian tsunami, the 2010 earthquake in Haiti, or the more recent 2011 earthquake in Japan that caused the tsunami and nuclear reactor damages.

Laura quotes Winston Churchill who said: "We make a living by what we get; we make a life by what we give."

Giving is universal, but to be effective and efficient, it should be strategic, that means that giving should be to where it does the most good. This means reflecting on who you are, what your passion is, and then thinking strategically how you can contribute your time, your money, or your skills. For example, if you work in the human resource department in your company, you probably have interviewing skills; you could share your expertise with an unemployed, job-seeking person by teaching effective interviewing skills, resume writing, or helping a person in conducting internet job searches. On a national scale, one could be involved in a program that facilitates for example micro lending, which is small loans to low-income entrepreneurs. The repayment rates of those loans have been phenomenal. In short, strategic giving is an idea worth spreading. ■■

## Reaction or Proaction?

To live within an environment and be responsive to it does not mean that managers should merely react in the face of stress. Because no enterprise can be expected to react very quickly to unforeseen developments, an enterprise must practice ways of anticipating developments through forecasts. An alert company, for example, does not wait until its product is obsolete and sales have fallen off before coming out with a new or improved product. A government agency should not wait until its regulations are obsolete and discredited before looking for another way to achieve its objectives. No enterprise should wait for problems to develop before preparing to face them. Proaction is an essential part of the planning process.

**LEADERSHIP PERSPECTIVE**

### Energy Independence—The Need of the Time[14]

The growing demand for energy demands leadership at the national level. One of President Obama's initiatives is to aim at energy independence. This requires new approaches to energy generation. This is not only a U.S. issue, but also a global one. Efforts are made around the globe. In Israel, some novel approaches are made

to make electricity from sunlight. The aim is to use less of the expensive silicon in electricity generation. This would still be about twice as costly as the conventional power stations, but the traditional cells are five times more expensive. Other efforts to harness sunlight for electricity generations are made at the Federal Polytechnic School in Lausanne, Switzerland. Other research is done in U.S. companies and universities such as at the University of California in Berkeley. ■■

## The Role of the Government

There are many instances in which social changes can be implemented only by the enactment of legislation. However, many managers in business and elsewhere have found it to their advantage to do something about pressing social problems. For example, many businesses have profited by filtering smokestack pollutants and selling or utilizing these recovered wastes. Some companies have made a profit by building low-cost apartment buildings in economically depressed areas. In other words, contributing to the solution of social problems does not always involve net expenses. But society may need the bludgeoning force of legislation to get improvements underway.

**LEADERSHIP PERSPECTIVE**

### Deng Xiaoping Who Changed China from the Planned Economy Towards a Market Economy[15]

Deng Xiaoping was a statesman, diplomat, and theorist. He has been credited with leading China from a planned economy to a market-driven economy that led to China's growth after the Cultural Revolution. He encouraged foreign investment and allowed limited private investment which resulted that China became one of the fastest growing economies today. Deng's idea of moving toward a market economy was:

"Planning and market forces are not the essential difference between socialism and capitalism. A planned economy is not the definition of socialism, because there is planning under capitalism; the market economy happens under socialism, too. Planning and market forces are both ways of controlling economic activity."[16]

When Deng Xiaoping visited Singapore in 1978, he was impressed by the modern, technologically advanced nation that planned its economic development, built its infrastructure and encouraged foreign investment. Deng considered Singapore's approach as the model for China resulting what has been called "socialism with Chinese characteristics." Combining the planning techniques with Singapore's developmental approach resulted in economic growth rates around 9 percent in recent years. China began building new coal mines, modern power grids, nuclear power plants, new roads and highways, and other projects. Much of the development can be attributed to the leadership of Deng Xiaoping. ■■

## ETHICS IN MANAGING: AN INTEGRATIVE APPROACH[17]

**Ethics** The discipline dealing with what is good and bad and with moral duty and obligation.

All persons, whether in business, government, university, or any other enterprise, are concerned with ethics. In Webster's Ninth New Collegiate Dictionary, **ethics** is defined as "the discipline dealing with what is good and bad and with moral duty and obligation". **Business Ethics** is concerned with a systematic study of morals. It strives to provide methods to distinguish between actions and attitudes that are detrimental for business and those that are sound ethically and inspire businesses.

**Business ethics** is concerned with a systemic study of morals, truth, and justice.

**LEADERSHIP PERSPECTIVE**

### Scandals and Corporate Governance[18]

In July 2002, WorldCom filed the largest bankruptcy claim in U.S. history. While the investors of WorldCom, Global Crossing, and other telecommunication companies were suffering, top managers of many of these companies were getting rich. Jack Grubman of Citigroup's Salomon Smith Barney seemed to have misled "outsiders," resulting in losses and bankruptcies that could hurt not only investors but also the U.S. telecommunication industry in the global competition with firms in countries such as South Korea and Japan, which already are technologically ahead of U.S. companies in certain areas.

Corporate scandals such as those of Enron and WorldCom have shaken the confidence of investors. In response to the disclosure of alleged improprieties, the United States initiated new legislation.

Starting from August 2002, chief executive officers (CEOs) and chief financial officers (CFOs) of many of the largest U.S. companies are required to state under oath that to the best of their knowledge the latest financial reports are true. Under the Sarbanes–Oxley law, CEOs and CFOs are required to certify the correctness of the reports to regain the confidence of investors. This legislation also stipulates that subsidized personal loans to executives be banned.

*Business Week* suggests several ideas for the creation of the ideal corporation, which must be built on integrity, ethics, fairness, and trust.[19] The new corporate model must be more transparent for investors, suppliers, customers, and employees. Performance data need to be accurate so that investors can trust the numbers. Executive pay must be perceived as being fair. The more open corporate culture needs to emphasize accountability, and employees must feel free to report unethical and unfair practices. ■■

There are widespread misunderstandings about business ethics: Not only that ethical concepts have quite often been dismissed in management theory as "soft" factors and quite often as useless chatter, business ethics according to another prejudicial view are merely some philanthropic efforts by companies.

The more fundamental problem stems from the fact that ethics has usually in theory and teaching not consistently been related to other management disciplines such as economics and finance. Ethical considerations have quite often been rejected right away as related to values and religion. Therefore, a rather isolated academic discipline assumed a kind of a fig leaf status besides simplified management theories focusing on cost cutting, profit maximization, and "efficiency".

The financial crisis between 2007 and 2009, along with numerous corporate scandals has been a powerful reminder of an economic system that lacks a necessary ethical framework. Volatility and unpredictability of the market system has been largely underestimated. Therefore, the conventional means of management education have come under fierce criticism due to their narrow-minded approach and for their apparent failure to prevent corporate scandals to happen.

**INTERNATIONAL PERSPECTIVE**

## Moving Toward a Global View?

Throughout the financial crisis, it became also clear that the financial architecture reflects a largely outdated post-war model largely dominated by rich nations of the developed countries. Countries such as India and China still lag on the margins along with other developing countries. There is evidence that a decisive factor that provoked such a large financial meltdown has been the sub-prime crisis in the United States. The crisis might be a reminder that a financial structure that represents in a more appropriate way the globalized world may be better equipped to create a stable financial and economic environment on a global and a local level.

In handling the crisis, it is also evident that countries like China and India proved much more resilient to overcome difficulties and hardships in comparison with their Western counterparts. Applying the principle of justice in the area of a more globalized financial and economic market means therefore to finally recognize that new dominant economic players such as India and China should be given their well-deserved position within a new financial architecture.

The macroeconomic implications of ethics need also to be analyzed in the way countries like China are becoming more and more involved in Africa. Are the business activities truly beneficial and in the vital interest of the people, or is beneath just another neo-colonial style reemerging which abuses natural resources, discriminative hiring, unsafe working conditions, and other issues.

A further element that makes ethics a must is the growing impact of consumer associations in developing countries that closely monitor how a product is produced. In addition, the ethical and unethical behavior of state and business leaders are becoming much more under scrutiny. ■■

## Ethical Theories[20]

**Utilitarian theory** Plans and actions should be evaluated by their consequences.

**Theory based on rights** All people have basic rights.

**Theory of Justice** Decision-makers must be guided by fairness and equity, as well as impartiality.

In organizations, managers compete for information, influence, and resources. The potential for conflicts in selecting the ends as well as the means to the ends is easy to understand, and the question of what criteria should guide ethical behavior becomes acute.

Three basic types of moral theories in the field of normative ethics have been developed. First, the **utilitarian theory** suggests that plans and actions should be evaluated by their consequences. The underlying idea is that plans or actions should produce the greatest good for the greatest number of people. Second, the **theory based on rights** holds that all people have basic rights. Examples are the rights to freedom of conscience, free speech, and due process. A number of those rights can be found in the Bill of Rights in the Constitution of the United States. Third, the **theory of justice** demands that decision-makers be guided by fairness and equity, as well as impartiality.

## Institutionalizing Ethics

The issue of business ethics is increasingly addressed in seminars and at conferences.[21] Managers, especially top managers, do have a responsibility to create an organizational environment that fosters ethical decision-making by institutionalizing ethics. This means applying and integrating ethical concepts with daily actions. Theodore Purcell and James Weber suggest that this can be accomplished in three ways: (1) by establishing an appropriate company policy or a code of ethics, (2) by using a formally appointed ethics committee, and (3) by teaching ethics in management development programs.[22] The most common way to institutionalize ethics is to establish a code of ethics; much less common is the use of ethics committees. Management development programs dealing with ethical issues are seldom used, although companies such as Allied Chemical, IBM, and General Electric have instituted such programs.

The publication of a code of ethics is not enough. Some companies require employees to sign the code and include ethics criteria in performance appraisal. Moreover, certain firms connect compensation and rewards to ethical behavior. Managers should also take any opportunity to encourage and publicize ethical behavior. At the same time, employees should be encouraged to report unethical practices. Most importantly, managers must set a good example through ethical behavior and practices.

**Code** A statement of policies, principles, or rules that guide behavior.

A **code** is a statement of policies, principles, or rules that guide behavior. Certainly, codes of ethics do not apply only to business enterprises; they should guide the behavior of persons in all organizations and in everyday life.

ETHICAL PERSPECTIVE

## Code of Ethics for Government Service

The U.S. federal government has established the following code.[23] Any person in government service should:

1. Put loyalty to the highest moral principles and to country above loyalty to persons, party, or Government department.
2. Uphold the Constitution, laws, and regulations of the United States and of all governments therein and never be party to their evasion.
3. Give a full day's labor for a full day's pay; giving earnest effort and best thought to the performance of duties.
4. Seek to find and employ more efficient and economical ways of getting tasks accomplished.
5. Never discriminate unfairly by the dispensing of special favors or privileges to anyone, whether for remuneration or not; and never accept, for himself or herself or for family members, favors or benefits under circumstances which might be construed by reasonable persons as influencing the performance of governmental duties.
6. Make no private promises of any kind binding upon the duties of office, since a Government employee has no private word that can be binding on public duty.
7. Engage in no business with the Government, either directly or indirectly, which is inconsistent with the conscientious performance of governmental duties.
8. Never use any information gained confidentially in the performance of governmental duties as a means of making private profit.
9. Expose corruption wherever discovered.
10. Uphold these principles, ever conscious that public office is a public trust.

■■

Simply stating, a code of ethics is not enough to ensure compliance, and the appointment of an ethics committee, consisting of internal and external directors, is considered essential for institutionalizing ethical behavior.[24] The functions of such a committee may include (1) holding regular meetings to discuss ethical issues, (2) dealing with "gray areas," (3) communicating the code to all members of the organization, (4) checking for possible violations of the code, (5) enforcing the code, (6) rewarding compliance and punishing violations, (7) reviewing and updating the code, and (8) reporting activities of the committee to the board of directors.

## Factors that Raise Ethical Standards[25]

The two factors that raise ethical standards the most, according to the respondents in one study, are (1) public disclosure and publicity and (2) the increased concern of a well-informed public. These factors are followed by government regulations and by education to raise the professionalism of business managers.[26]

For ethical codes to be effective, provisions must be made for their enforcement. Unethical managers should be held responsible for their actions. This means that privileges and benefits should be withdrawn and sanctions should be applied. Although the enforcement of ethical codes may not be easy, the mere existence of such codes can increase ethical behavior by clarifying expectations. On the other hand, one should not expect ethical codes to solve all problems. In fact, they can create a false sense of security. Effective code enforcement requires demonstration of consistent ethical behavior and support from top management. Another factor that could raise ethical standards is the teaching of ethics and values in higher education institutions.

## Guidelines for International Business Ethics with a Focus on China[27]

With increased business activities in China, decision-makers search for guidelines. Stephan Rothlin with his book 18 Rules of International Business Ethics, Becoming a Top-Notch Player aims not only to assist managers to be ethical, but also to be successful. Although the book was written primarily for Chinese managers (the text in the book is side-by-side in English and Chinese), the concepts certainly have wider applications. The guides are discussed in four parts dealing with international business ethics, labor conditions, justice, and virtue ethics. It is clear that those guides focus on many current issues in China as well as in other countries.

### Part 1 International Business Ethics

1. If you strive to understand the values of different cultures, you will find common points
2. If you analyze the facts, you will realize that honesty and reliability benefit you
3. If you analyze case studies from difference perspectives, you will discover the benefits of fair plan

### Part 2 Labor Conditions

4. Respecting your colleagues is the smartest investment you can make
5. To increase productivity, provide safe and healthy working conditions
6. To inspire trust, make your performance transparent
7. Your loyal dissent can lead your institution in the right direction
8. Downsizing your labor force is only beneficial when you respect each stakeholder

### Part 3 Areas of Justice

9. To establish your brand name, act as a fair competitor

10. Reduce the gap between the rich and poor by developing a new social security system
11. If you act against discrimination, you will increase your productivity and profitability
12. If your protect intellectual property, all stakeholders will receive their due share
13. Ongoing changes in information technology require new forms of loyalty
14. Your public relations strategy will only secure your reputation if it witnesses your drive for quality and excellence
15. Your economic achievements will only stand on firm ground if you diminish corruption
16. Long-term success urgently calls you to constantly care for the environment

### Part 4 Towards Virtue Ethics

17. To become a refined player, sharpen your discernment and cultivate good manners
18. Care for your business by caring for society

China's fast economic growth (around 10 percent for several years), results in increased business activities. Business leaders search for guidelines to operate not only in their country, but compete globally. These guides may assist Chinese managers as well as those in other countries in their decision-making.

## Whistle-blowing

**Whistle-blowing** Making known to outside agencies unethical company practices.

Another way of encouraging ethical corporate behavior is through **whistle-blowing**, which means making known to outside agencies unethical company practices. Black's Law Dictionary defines a whistle-blower as "an employee who refuses to engage in and/or reports illegal or wrongful activities of his employer or fellow employees." There is even a whistle-blower website that discusses whistle-blowing issues, including legal matters and protection.[28] This whistle-blowing center is a nonprofit organization that helps enforce environmental laws and works for the accountability of business and government organizations. Its primary objective is to protect and defend persons who disclose actions harmful to the environment and public health.

As we will discuss later in this book in greater detail, Roger Boisjoly, an engineer at Morton Thiokol, the contractor for the rocket booster in the Challenger space shuttle, pointed out the problem with the O-rings, which became ineffective at low temperatures. His fears and concerns were largely ignored by management and eventually led to the Challenger disaster. Another example is that of Mr. Ruud, a whistle-blower who was fired from his job at the nuclear plant operator Westinghouse Hanford Company. He sued the company and was awarded by a federal judge an entitlement for lifetime front pay.[29] In America, legislation now gives greater protection to government whistle-blowers. There is some evidence that after September 11, 2001, World Trade Center suicide attacks, more employees have come forward to disclose security issues.[30]

## Differing Ethical Standards between Societies[31]

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Ethical as well as legal standards differ, particularly between nations and societies. For example, certain nations permit privately owned companies to make monetary contributions to political parties, campaigns, and candidates (which is prohibited in the United States). In some countries, payments to government officials and other persons with political influence to ensure favorable handling of a business or other transactions are regarded not as bribes but as payments for services rendered. In some cases, payments made in order to win a contract are even looked upon as a normal and acceptable way of doing business. Consider the Quaker Oats Company, which faced a situation in which foreign officials threatened to close its operation if the demand for "payouts" was not met; or a company may find itself in a predicament where its plant manager's safety will be in jeopardy if payoffs are not made.[32] The question facing responsible foreign business managers is: What ethical standards should they follow?[33] For example, guanxi, which pertains to informal relationships and exchange of favors, influences business activities in China and East Asia. There is no question of what to do in similar situations in the United States: executives have to refuse the suggestion of putting money in a "paper bag." But in a country where such practices are expected and are common, American executives are faced with a difficult problem. With the passage of laws by the U.S. Congress and the adoption of regulations by the Securities and Exchange Commission, not only must American firms report anything that could be called a payoff but also anything else that can be construed as a bribe is unlawful. The Foreign Corrupt Practices Act (FCPA) Anti-bribery Provisions state: "U.S. firms seeking to do business in foreign markets must be familiar with the FCPA. In general, the FCPA prohibits corrupt payments to foreign officials for the purpose of obtaining or keeping business."[34] Thus, the United States has attempted to export its standards for doing business to other countries, which can improve ethical standards abroad.

**INTERNATIONAL PERSPECTIVE**

## Truth in Advertising Regulations Differ in Various Countries[35]

Advertising in China is getting tougher. Proctor & Gamble (P&G) claimed that its Pantene product makes the hair ten times stronger. Government authorities demanded proof which was difficult to show through objective studies. Consequently, P&G withdrew the advertising. In the past, advertisers in China were relatively free in making claims for their products. Yet, a 1995 Chinese law that states statistical claims should be accurate and true, had rarely been enforced.

Advertising regulations differ among countries. In the U.S., for example, the Federal Trade Commission provides an oversight. Moreover, competitors also watch for and expose questionable claims of their adversaries. In most European countries, industry is guided by self-regulation as well as strong governmental regulation. ■■

## TRUST AS THE BASIS FOR CHANGE MANAGEMENT

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Managers are bombarded with new managerial concepts, and old ones often are disguised by new terminology—all designed for coping with managerial change demanded by global competition, customer expectations, and the need to respond quickly to environmental changes. Although various approaches to managing change in the New Age will be discussed throughout the book, one often-overlooked concept is trust. Professor Salvatore Belardo points out that trust is at the center of communication, collaboration, and the willingness to change.[36] Traditionally, the concept of trust is equated with integrity, loyalty, caring, and keeping promises in the relationships between and among individuals. Belardo, however, points out that trust should go beyond individual relationships and extend to the organization through the creation of a culture of trust that transcends individual leadership. Leaders come and go; the organization continues. For example, David Packard of Hewlett-Packard left as his legacy the HP Way, a philosophy that emphasizes a code of ethics, which permeates the whole organization and continues after his death.

In this book, many managerial concepts, principles, theories, and practices will be introduced for managing change in the New Age. But an enterprise is essentially a human organization, which functions well only when it is based on trust, ethical behavior, and the recognition of human dignity.

## SUMMARY

Managers operate in a complex environment. They are affected by—and to some extent influence—the environment. Managers operate in a pluralistic society in which many organized groups represent various interests.

In their decision-making, managers must consider the external environment. Technology provides many benefits but also creates some problems. Increasingly, firms are considering the impact of managerial actions on the ecological environment. Many business corporations and other organizations are making serious efforts to establish an environment that is beneficial to individuals, business, and society.

Corporate social responsibility requires that organizations consider seriously the impact of their actions on society. Similarly, social responsiveness is relating corporate operations and policies to the social environment in ways that are beneficial to both the company and society. Determining the appropriate relationships between various types of organizations and society is not an easy task, and one can make arguments for and against business involvement in social activities. However, there is now a general recognition that the responsibility of business goes beyond profit maximization.

Ethics deals with what is good and bad as well as with moral duty and obligation. There are three moral theories in normative ethics: the utilitarian theory, the theory based on rights, and the theory of justice. Some authors have suggested that businesses institutionalize ethics and develop a code of ethics. There are also other factors that raise ethical standards, including whistle-blowing. Managers have to make difficult choices when the standards differ in other societies. Trust is the foundation for human relations and modern management approaches.

## KEY IDEAS AND CONCEPTS FOR REVIEW

- ✔ Pluralistic society
- ✔ Technological environment
- ✔ Ecological environment
- ✔ Corporate social responsibility
- ✔ Social responsiveness
- ✔ Arguments for and against social involvement of business
- ✔ Government's role in enforcing ethical behavior
- ✔ Ethics
- ✔ Ethics in Managing: An Integrative Approach
- ✔ Utilitarian theory of ethics
- ✔ Ethical theory based on rights
- ✔ Ethical theory of justice
- ✔ Institutionalizing ethics
- ✔ Code of ethics
- ✔ Factors raising ethical standards
- ✔ Eighteen Guides of international business ethics
- ✔ Whistle-blowing
- ✔ Differing ethical standards
- ✔ Trust as a critical factor for change

## FOR DISCUSSION

1. Why is the environment external to an enterprise so important to all managers? Can any manager avoid being influenced by the external environment?
2. Identify the elements of the external environment that are likely to be the most important to each of the following: a company president, a sales manager, a production manager, a controller, and a personnel manager.
3. What are the major social responsibilities of business managers? Of public administrators? Have these responsibilities changed over the years? How?
4. If you were the chief executive of a large corporation, how would you institutionalize ethics in the organization?
5. What ethical codes would you recommend for your university, your class, and your family? How should these codes be enforced?

## EXERCISES/ACTION STEPS

1. The class should select and read an article published in a recent issue of the *Wall Street Journal*, *Business Week*, or *Fortune* that raises some ethical issues. Divide the class into groups and analyze the situation using the ethical theories discussed in this chapter.
2. Interview one business manager and one administrator in the local government and ask how they perceive their social responsibilities. Do these responsibilities relate primarily to the environment external to the organization, or do they also include internal aspects?

## INTERNET RESEARCH

1. Search the Internet for "business ethics" and select two articles for class discussion.
2. Cars do pollute the air. Search the Internet for "ecology" and "cars" to find out what car makers are doing to reduce pollution.
3. Search the Internet for "knowledge age" and describe three developments that might affect you or provide opportunities for you.

## International Case Spirituality in the Workplace[37]

Traditionally, the workplace and spirituality did not mix in America. But things are changing. Andre Delbecq, a professor at Santa Clara University, a Jesuit institution, said, "There were two things I thought I'd never see in my life, the fall of the Russian empire and God being spoken about in a business school." Now management books and conferences (including the annual meeting of the Academy of Management) deal with the various aspects of how God can be brought into the organizational environment. To be sure, people who want to integrate spiritual dimensions into the workplace are still considered rebels. But ServiceMaster, a Fortune 500 company with some 75,000 employees, created a spiritual organization culture many years ago. Indeed, Peter Drucker, one of the most prolific writers on management, had high regard for the company that is known for its products such as Terminix, TruGreen, and Merry Maids.

When people in the United States were asked if they believe in God, some 95 percent said yes. It is in a spiritual context that businesspeople under the daily pressure of work can discuss their inner feelings. As the baby boomers, now in their 50s, are reaching the top in their corporate life, they begin to wonder what life is all about. They lived through the youth culture of the 1960s and the greed-dominated 1980s. They are now questioning the real meaning of life and the ethical dimension of work. Jose Zeilstra, an executive at PriceWaterhouseCoopers, worked around the world, practicing her Christian principles in different cultures. During her assignment in China, she strongly argued against the practice of giving "very expensive gifts." As a result, the business deal did not work out. Yet, in the long run, integrating her personal beliefs with her work resulted in a very successful career. Academic institutions such as the University of St. Thomas, University of Denver, and Harvard Divinity School are following and studying the movement of spirituality. Other American schools such as Antioch University, University of New Haven, University of Scranton, and Santa Clara University, as well as institutions abroad such as the University of Bath in England and the Indian Center for Encouraging Excellence in India, are conducting research, conferences, or lectures on spirituality.

The cover story of *Business Week* (November 1, 1999) discussed how companies such as Taco Bell, Pizza Hut, McDonald's, and Xerox pay attention to the spiritual needs of their employees. Some companies claim an increase in productivity, decrease in turnover, and reduction in fear. A research study by the consulting firm McKinsey in Australia found that firms with spiritual programs showed reduced turnover and improved productivity. Professor Ian I. Mitroff at the University of Southern California even stated, "Spirituality could be the ultimate competitive advantage." But there is also the concern that cult members and groups with a radical perspective could use the workplace for their own aims. Still, employees in companies that integrate

spirituality in their workplace count on the potential benefits of greater respect for individuals, more humane treatment of their fellow workers, and an environment with greater trust that permeates their organization.

**Questions**

1. What does spirituality mean to you?
2. Could spirituality affect ethical behavior?
3. Is this topic appropriate for business?
4. What are the arguments for and against inclusion of spirituality in business?

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# 3 Global, Comparative, and Quality Management

## CHAPTER OBJECTIVES

After studying this chapter, you should be able to:

- Discuss the nature and purpose of international business and multinational corporations
- Understand country alliances that form trade blocs
- Appreciate cultural and country differences and their implications for managing
- Recognize the differences in managing in selected countries
- Describe the managerial practices in Japan and Theory Z
- Understand the factors that influence the competitive advantages of nations, according to Michael Porter
- Recognize the major contributions to quality management and describe the Baldrige quality award, ISO 9000, and the European Quality Award

The previous chapter focused on the external factors that are present especially in the domestic environment. The constraining factors on managing are likely to be more severe for international firms. Executives operating in a foreign country need to learn a great deal about the country's educational, economic, legal, and political systems and especially its sociocultural environment.

The first section in this chapter deals with international management and the role of multinational corporations. Then the environmental impact on managing in selected countries is examined, with special attention given to Japanese managerial practices. Finally, the competitive advantage of nations and quality management are discussed.

## INTERNATIONAL MANAGEMENT AND MULTINATIONAL CORPORATIONS

**International management** focuses on the operation of international firms in host countries.

The study of **international management** focuses on the operation of international firms in host countries. It is concerned with managerial issues related to the flow of people, goods, and money, with the ultimate aim of managing better in situations that involve crossing national boundaries.

The environmental factors that affect domestic firms usually are more critical for international corporations operating in foreign countries. As illustrated in Table 3.1, managers involved in international business are faced with many factors that are different from those of the domestically oriented firm. They have to interact with employees who have different educational and cultural backgrounds and value systems; they also must cope with different legal, political, and economic factors. These environments understandably influence the way managerial and enterprise functions are carried out.

**Table 3.1** Managing Domestic and International Enterprises

| *Managerial function* | *Domestic enterprise (in industrialized country)* | *International enterprise* |
|---|---|---|
| **Planning** | | |
| • Scanning the environment for threats and opportunities | • National market | • Worldwide market |
| **Organizing** | | |
| • Organization structure | • Structure for domestic operations | • Global structure |
| • View of authority | • Similar | • Different |
| **Staffing** | | |
| • Sources of managerial talent | • National labor pool | • Worldwide labor pool |
| • Manager orientation | • Often ethnocentric | • Geocentric |
| **Leading** | | |
| • Leadership and motivation | • Influenced by similar culture | • Influenced by many different cultures |
| • Communication lines | • Relatively short | • Network with long distances |
| **Controlling** | | |
| • Reporting system | • Similar requirements | • Many different requirements |

## The Nature and Purpose of International Business

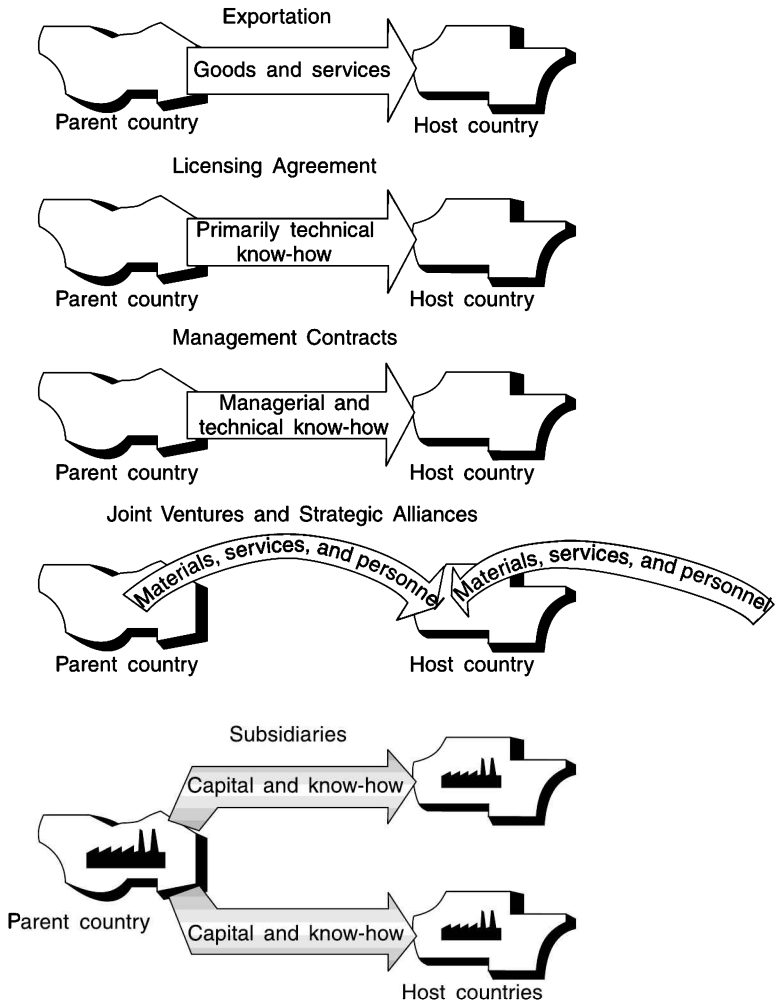
**International businesses** engage in transactions across national boundaries.

Although business had been conducted on an international scale for a long time, international business gained greater visibility and importance because of the growth of large multinational corporations. **International businesses** engage in transactions across national boundaries. These transactions include the transfer of goods, services, technology, managerial knowledge, and capital to other countries.

The interaction of a firm with the host country can take many forms, as illustrated in Figure 3.1. One is the exportation of goods and services. Another is a licensing agreement for producing goods in another country. The company may also engage

**Figure 3.1**

**Forms of International Business.**




in management contracts for operating foreign companies. Still another form of interaction is a joint venture with a firm in the host country. One form of joint venture is the strategic alliance that is often formed in order to expand geographically (airlines do this extensively), or to expand the market for products or services. Finally, multinationals may set up wholly owned subsidiaries or branches with production facilities in the host country. Thus, in developing a global strategy, an international firm has many options.

The contact between the parent firm and the host country is affected by several factors; some are unifying, while others can cause conflicts.

**Unifying effects** Unifying influences occur when the parent company provides and shares technical and managerial know-how, thus assisting the local company in the development of human and material resources. Moreover, both partners may find it advantageous to be integrated into a global organizational structure. Whatever the interaction, organizational policies must provide for equity and result in benefits for both the parent firm and the local company. Only then can one expect a long-lasting relationship.

LEADERSHIP PERSPECTIVE

### Who Will Be Leading the Way to Cost-Effective Cars?[1]

With high gasoline prices and saturated markets in developed countries, carmakers focus now on emerging markets. These markets need cheap cars and manufacturers respond. However, cars should not only be cheap, but also robust and reliable. Carlos Ghosn, Renault-Nissan's CEO, in the past focused on large, expensive cars. Now Renault plans are to build a $3,000 car with Bajaj Auto Ltd., an Indian motorbikes maker. Renault has been very successful with its Logan model that sold in India for about $7,500, a car that was suited for the middle class. Renault moved to the low-cost car, produced in Romania. While the Logan has made no inroads in Western Europe, it is now produced in seven countries such as Columbia and Russia.

Chrysler together with China's Chery Automobile Co. is planning to sell cars in Europe under the Dodge name. General Motors plans operations in Argentina and Brazil and opening engineering centers in India, Korea, and Brazil.

Traditionally, customers in developing countries bought used European and Japanese cars. Now, African customers look for cheap cars. New cars from China are replacing used cars imported from developing countries. Chinese companies such as Great Wall, Chery Automobile Co., and Geely Group Ltd. are making inroads in Africa. India's TATA Motors is offering a car for less than $2,500. Western manufacturers such as French Renault and Japan's Nissan Motors Co. are working together with India's Mahindra & Mahindra Ltd. in developing a $3,000 car. Renault already sells a budget car produced in Romania.

Emerging countries demand cost-effective cars, and the carmakers respond to these needs using global strategies. Global needs for cheap cars unify countries. ■■

**Potentials for conflict** Many factors can cause conflicts between the parent firm and the host country. Nationalistic self-interest may overshadow the benefits obtained through cooperation. Similarly, sociocultural differences can lead to a breakdown in communication and subsequent misunderstandings. Also, a large multinational firm may have such overpowering economic effects on a small host country that the latter feels overwhelmed. Some international corporations have

been charged with making excessive profits, hiring the best local people away from local firms, and operating contrary to social customs. International corporations must develop social and diplomatic skills in their managers to prevent such conflicts and to resolve those that unavoidably occur.

## Multinational Corporations

**Multinational corporations** have their headquarters in one country but operate in many countries.

**Multinational corporations** (MNCs) have their headquarters in one country but operate in many countries. *Fortune* magazine annually identifies the 500 largest global companies. Of the ten largest corporations ranked by revenues in 2006, six were American, one German/American, one British/Dutch, one British, and one Japanese. These companies were (1) Exxon Mobil, (2) Wal-Mart Stores, (3) Royal Dutch Shell, (4) BP (British Petroleum), (5) General Motors, (6) Chevron, (7) DaimlerChrysler, (8) Toyota Motor Corporation, (9) Ford Motor Company, and (10) ConocoPhillips[2]

*Fortune* also ranked the most admired global companies. In 2006, American companies took nine of the top ten positions (with General Electric ranking number one and Japan's Toyota Motor was number two.[3])

**Ethnocentric orientation** The style of the foreign operations is based on that of the parent company.

**Polycentric orientation** The foreign subsidiaries are given a great deal of managerial freedom.

**Regiocentric orientation** The foreign operations are staffed on a regional basis.

**Geocentric orientation** The entire organization is viewed as an interdependent system operating in many countries.

**From ethnocentric to geocentric orientation[4]** In its early stages, international business was conducted with an **ethnocentric** outlook, with the orientation of the foreign operation based on that of the parent company.[5] The **polycentric** attitude, on the other hand, is based on the notion that it is best to give the foreign subsidiaries, staffed by local nationals, a great deal of managerial freedom. It is assumed that local nationals understand the local environment best. A **regiocentric** orientation favors the staffing of foreign operations on a regional basis. Thus, a European view may be composed of British, French, German, Italian, and other European influences. The modern MNC has a **geocentric** orientation. This means that the entire organization is viewed as an interdependent system operating in many countries. The relationships between headquarters and subsidiaries are collaborative, with communication flowing in both directions. Furthermore, key positions are filled by managers of different nationalities. In short, the orientation of the MNC is truly international and goes beyond a narrow nationalistic viewpoint.

**Advantages of multinationals** MNCs have several advantages over firms that have a domestic orientation. Obviously, the MNC can take advantage of business opportunities in many different countries. It can also raise money for its operations throughout the world. Moreover, it benefits by being able to establish production facilities in countries where its products can be produced most cost-effectively and efficiently. Companies with worldwide operations sometimes have better access to natural resources and materials that may not be available to domestic firms. Finally, large MNCs can recruit managers and other personnel from a worldwide labor pool.

**Challenges for multinationals** The advantages of multinational operations must be weighed against the challenges and risks associated with operating in foreign environments. One problem is the increasing nationalism in many countries. Years ago, developing countries lacked managerial, marketing, and technical skills. Consequently, they welcomed MNCs. But the situation is changing, with people in develop-

ing countries also acquiring those skills. In addition, countries have not only become aware of the value of their natural resources but have also become more skilled in international negotiations. Finally, MNCs must maintain good relations with the host country, a task that may prove difficult in some countries because their governments frequently change and corporations must deal with, and adapt to, these changes.

**LEADERSHIP PERSPECTIVE**

### Challenges and Opportunities for Chairman Azim H. Premji at Wipro[6]

Challenges for some companies can be opportunities for others. In the late 1970s IBM was selling obsolete and outdated machines in India. The Indian government told the company to change to newer equipment or it would have to leave. IBM left, creating opportunities for Indian companies such as Wipro which was a very small company in the late 1970s. But by 2006 the company grew to be a $3 billion firm by providing information technology, business process operations, and R&D services serving customers throughout the world.

Wipro, under the Stanford University educated Chairman Azim H. Premji, took advantage of the outsourcing trend. Developed countries began manufacturing outsourcing to China, while India, with a well-educated, English-speaking workforce began outsourcing services. Wipro and other Indian companies provided services such as call centers, payroll software for foreign companies, interactive training systems, and portfolio management for insurance companies. Today, India is considered to be a low-cost quality IT services provider.

These high-tech companies, such as Wipro, can draw students from highly respected institutes such as the Indian Institute of Technology and the Indian Institute for Management in Bangalore. Wipro, which began as a peanut oil producing company is now growing in the innovation business with sophisticated R&D capabilities.

■■

## From Multinational to Global or Transnational Corporations

**Global or transnational corporations** view the whole world as one market.

www.exxon.com

www.gm.com

www.ford.com

www.mazda.com

Just operating in different countries is not enough for large corporations; nor is the establishment of manufacturing plants in several countries (as Exxon and General Motors have done) sufficient to be competitive in the world market. The shift is toward the **global, or transnational, corporation**, which views the whole world as one market. This means, however, that a corporation also has to adapt to national and even local needs.

Domestic markets have become too small. Developing a drug may cost several hundred million dollars and may take more than ten years. To recover the costs it requires selling the drug in a world market. Moreover, global companies have to keep abreast of technological developments around the world. Ford Motor Company

decided in the latter half of the 1980s to become a global corporation. Previous attempts to build the "world car" (named the Escort) were not very successful. However, the use of modern communication technology, such as teleconferencing, establishes now a much closer link between Ford's headquarters and its European operations. While Ford was aiming at becoming a global corporation, it had no plants in Japan. To compensate for this void, Ford bought a 25 percent share in Mazda, which was later increased to 33.4 percent. After Ford gained a controlling interest, Henry Wallace was appointed president, the first foreigner to lead a major Japanese firm.[7] Moreover, the company has another project with Nissan in Japan that designed the minivan built by Ford and marketed as the Villager and as the Quest that is sold by Nissan dealerships.

While many firms are aiming at becoming global, only a few have really done so. It requires developing products with the whole world in mind, especially the markets in North America, Asia, and Western Europe. Similarly, strategic decisions must take into account the whole world, but tactics must be adapted to the national and local environments. In staffing, opportunities must be opened for non-nationals to move into upper management ranks. In countries where the global corporation cannot enter, strategic alliances may need to be formed with local companies.

**INTERNATIONAL PERSPECTIVE**

## Can eBay's Success Continue?[8]

With the Internet changing rapidly, can eBay's success continue? Around 1994, Pierre Omidjar started using the Internet for trading. Today, eBay is more than a trading company with millions of items on sale; the company has now about one-quarter of all e-commerce sales when excluding groceries and travel. The company was expected to make about $1 billion in profits in 2005, using a unique business model in which the users do most of the work that includes picturing, describing, listing, packing, and sending their goods. The company then collects a fee for each transaction. One of the lucrative services offered by eBay is PayPal that offers on-line payments for about three-quarters of the values traded in America. The firm's popularity is growing abroad and eBay is focusing not only on Europe, but also other countries, especially China. Cross-border trading is expected to continue to grow and eBay invested some $100 million for promoting the company in China.

Will eBay's success continue? Its U.S. market rate growth is slowing and other Internet companies expanding their services. Google, for example, has become more than a search engine, Amazon sells many more things than books, and Yahoo! is now more than a web portal. In fact, both Amazon and Yahoo now also offer auctions. In the past, eBay was successful because the company listened to its customers and their needs. But will this be enough for the future? After all, entry barriers into a business are relatively low when compared with most offline businesses. ■■

## COUNTRY ALLIANCES AND ECONOMIC BLOCS

At one time, countries in a region were competing against each other (and they still do). But now, countries are forming regional alliances that have regions compete with each other. Examples are the European Union, the North American Free Trade Agreement (NAFTA), the Association of Southeast Asian Nations (ASEAN), and Mercosur.

### European Union

Europe 1992 marked the completion of the first stage of European economic ties. The European Community (EC) 1992 program caused dramatic shifts in economic power. Some saw the new program as the New Europe, while others, especially outsiders, saw it as a fortress that could provide serious challenges to other countries, including the United States. In order to compete effectively, North American and Asian countries prepared for the New Europe by forming NAFTA and ASEAN.

www.siemens.com

The European Commission worked on some 300 legislative actions for removing trade barriers and creating an internal market. The new measures were intended to increase market opportunities, escalate competition within the EC, and boost competition from companies outside the EC. The abolition of transnational trade restrictions and the relaxation of border controls had a considerable impact on U.S. companies doing business in Europe. Moreover, strong European companies have become formidable competitors in the U.S. market, as illustrated by Siemens, the German global company.

The objective of Europe 1992 was to create a single market through the removal of trade barriers and through free movement of goods, people, service, and capital. The changes go beyond economic interests and encompass many social changes as well. Educational qualifications, for example, are also affected. The Council of Ministers submitted a directive that recognizes diplomas of higher education across national boundaries, making it easier for professionals to work in different countries. It is clear, then, that the EC is more than an economic community: it is a state of mind with political power.

www.europa.eu.int

The original EC 1992 (which later became the European Union) consisted of 12 member nations: Belgium, Denmark, France, Germany, Greece, Ireland, Italy, Luxembourg, the Netherlands, Portugal, Spain, and the United Kingdom. It expanded in 1995 to include Austria, Finland, and Sweden. Since then, Cyprus, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Malta, Poland, Slovakia, and Slovenia have been admitted.

### North American Free Trade Agreement and Other Latin American Free Trade Blocs[9]

www.nafta-sec-alena.org

In 1994, NAFTA, which included agreements among the United States, Canada, and Mexico, went into effect. Since then, trade among those countries has increased greatly. The objectives of NAFTA are to eliminate trade barriers and facilitate cross-border movements of goods and services, promote fair trade, increase investment opportunities, protect intellectual property, provide for resolution of disputes, and

present opportunities to improve the benefits of this agreement. The agreement covers a variety of areas, such as market access, rules governing the origin of goods, customs procedures, energy, agriculture, and measures to be taken in emergencies.

www.mercosur.org
www.ftaa-alca.org

Other Latin American and Caribbean countries have also formed their own trade blocs. Argentina, Brazil, Bolivia, Chile, Paraguay, and Uruguay are members of the Mercosur group.[10] The European Union has extensive trade with Mercosur members, which was further strengthened by the Fifth Round of Association negotiations held in July 2001. In addition, the Caribbean and Central and South American countries consider reductions in trade barriers through the Free Trade Area of the Americas (FTAA), which some consider an extension of NAFTA.

These trade agreements, however, do not go unchallenged, as shown by the protests at World Trade Organization meetings. Critics see them as benefiting only developed nations.

## Association of Southeast Asian Nations (ASEAN)[11]

www.aseansec.org

The ten countries of Brunei Darussalam, Cambodia, Indonesia, Laos, Malaysia, Myanmar, the Philippines, Singapore, Thailand, and Vietnam formed a trading bloc that will increasingly counter NAFTA and the European Union, not only economically but also politically.

During the ASEAN summit conference in October 2003 in Bali, the leaders discussed political security, sociocultural cooperation, and economic issues with the leaders of China, Japan, India, and South Korea. Also, ASEAN economic ministers meet frequently to discuss economic issues and strategies. The 35th such meeting was held in Phnom Penn in September 2003. The following month, ASEAN ministers held the inaugural meeting on culture and arts in Kuala Lumpur, Malaysia. The goal of the meeting was to improve cooperation among ASEAN countries, enhance understanding among their people, and promote a regional identity. More recently, the countries also begin to cooperate to fight terrorism. Eventually, the ASEAN alliance could rival NAFTA and the European Union.

**INTERNATIONAL PERSPECTIVE**

### Thailand's Competitive Advantage: Pickup Trucks[12]

As the U.S. and Thailand prepared for the new trade pact, American car companies and unions and Thai bankers feared greater competition. Thailand's banking industry had been protected from foreign competition. Thailand's pick-up trucks could pose formidable competition to U.S. car makers. Thailand has already a free-trade agreement (FTA) with Japan and the U.S. does not want to fall behind in influence in South-east Asia where China increasingly gains foothold in that region.

Thai pick-up trucks could provide tough competition to the U.S. industry if the 25 percent tariff were removed from imported pickups. In early 2006, the tariff issue had not yet been decided. American unions were very concerned about job losses

especially since Ford announced in January 2006 that during the next six years it will close some 14 plants in North America resulting in the loss of some 34,000 jobs. Similarly, General Motors also faces the need for downsizing its labor force.

But, Ford and GM could also benefit greatly from the trade deal. Both companies produce pickup trucks in Thailand which, however, have been sold primarily in South-east Asia, but none in the U.S. It is Thailand's aim to become "the Detroit of the East." If the FTA between Thailand and the U.S. proceed as planned, the pick-up truck industry could contribute to Thailand's competitive advantage. ■■

## India's Role in the World Economy

Geographically, India is the seventh largest country ranking second in number of people after China. In contrast to China, India is a democracy with some 1.2 billion people and the second largest labor force. India is the 12th largest economy. It is estimated that by 2025 India's market will be surpassing the consumer market in Germany.[13] Despite the economic growth, India still has a high poverty and illiteracy level.[14] In 1947, India became independent from British rule followed by a new constitution in 1950. India plays an increasing role in the World Trade Organization (WTO), in the Association of Southeast Asian Nations (ASEAN) and in the South Asian Association for Regional Cooperation (SAARC).

**LEADERSHIP PERSPECTIVE**

### Manmohan Singh, Prime Minister of India[15]

As Finance Minister, Manmohan Singh opened India to the world by carrying out the economic reforms in 1991. The American *Newsweek* magazine described him as "the leader other leaders love."[16]

When Mr. Singh became the Finance Minister in 1991, the fiscal deficit was over 8 percent of gross domestic product. Later, as Prime Minister, Mr. Singh focused on economic policy with favoring globalization, health care, and education by opening, for example, several Indian Institutes of Technology. He also paid attention to security and home affairs.

The foreign policy included several initiatives such as ending the border dispute with China. The developing good relations resulted in China becoming the second most important trading partner of India. Similarly, Mr. Singh strengthened the ties with the United States, signing the civilian nuclear agreement with the then President George W. Bush. This agreement was followed by Mr. Singh being invited by President Obama to an official White House Visit. Mr. Singh generally projects a favorable public image, although the opposition considers him weak. Nevertheless, Mr. Singh is perceived by the world as a global leader. ■■

## INTERNATIONAL MANAGEMENT: CULTURAL AND COUNTRY DIFFERENCES[17]

It is interesting to know some of the differences in managerial practices. A comprehensive study by Geert Hofstede provides a good framework for studying cultural differences between countries. Our discussion will focus on selected countries. It is illustrative, rather than comprehensive, and is based on generalizations. We have to bear in mind that there are, for example, great differences between the managers in any country. Furthermore, a society is not static, and changes do occur over time. For instance, the traditional authoritarian style of German managers is slowly giving way to a more participative approach.

### Behaviors in Different Cultures[18]

The study by Geert Hofstede, a Dutch researcher, found that a country's culture impacts on the behavior of employees. In his initial study of more than 110,000 people, he identified four dimensions and later added a fifth. They are (1) individualism versus collectivism, (2) large versus small power distance, (3) uncertainty tolerance versus avoidance, (4) masculinity versus femininity or aggressive versus passive goal behavior, and (5) short- versus long-term orientation. The behaviors in the five dimensions are summarized in Table 3.2.

**Table 3.2** Five Dimensions of Behavior

| *Individualism* | *Collectivism* |
|---|---|
| People focus on their own interests and the people close to them. Tasks more important than relationships. | Emphasis on the group, with group support expected. Relationships more important than task orientation. |
| **Large power distance** | **Small power distance** |
| Society accepts unequal distribution of power. Respect for authority. Emphasis on titles and ranks. Subordinates expect to be told what to do. Centralization emphasized. | Society less accepting of power. Employees more open to the idea of dialog with their superior. Less emphasis on authority, titles, and ranks. Inequality minimized. Decentralization emphasized. |
| **Uncertainty tolerance** | **Uncertainty avoidance** |
| People accept uncertainty and are open to risk taking. Willing to take risks. | Afraid of ambiguity and uncertainty. Structure and formal rules preferred. |
| **Masculinity*** | **Femininity** |
| Aggressive and assertive behavior. Emphasis on material things, success, and money. | Relationship-oriented. Quality of life favored. Concern for the welfare of others; caring. Emphasis on modesty. |
| **Long-term orientation** | **Short-term orientation** |
| Characterized by hard work and perseverance. Savings-driven. | Less emphasis on hard work and perseverance. Consumption-driven. |

*Some authors prefer to use the terms *quantity versus quality of life* or *aggressive versus passive goal orientation* instead of *masculinity versus femininity*, the terms Hofstede used originally.

The results of Hofstede's research showed that, for example, individualism prevailed in the United States, Australia, Britain, and Canada. In contrast, collectivism prevailed in countries such as Guatemala, Ecuador, and Panama. Among the 50 countries studied, India ranked 21, close to the Japanese ranking (22/23). On the other hand, Hong Kong, Singapore, Thailand, and Taiwan ranked between 37 and 44, indicating a tendency toward collectivism.[19] On the masculinity/femininity index, Japan, Austria, Italy, and Switzerland ranked high, while Sweden, Norway, the Netherlands, and Denmark ranked low, meaning that these countries are skewed toward feminism.[20]

These findings suggest that managers need to understand the cultural environments and their implications in order to be successful in the country in which they do business. We shall now discuss the management styles in selected countries.

## France: *Le Plan* and the *Cadre*

In France, government planning on a national scale (legal–political environment factor) helps coordinate the plans of individual industries and companies (managerial function of planning). The government's aim is to utilize most effectively the country's resources and to avoid expansion in uneconomic areas. Although government planning—which is also extended to regional areas—is carried out by relatively few, but competent, people, other government departments, employers' organizations, unions, and consumers provide cooperation and assistance.

At times, the plan becomes a global strategy helping specific industries. For example, the government attempts to integrate the electronics industry into a whole so that it can overcome its weaknesses in information processing, consumer electronics, microelectronics, and automation. To implement the strategy, the government plans to support several national projects, such as speech synthesis, mini- and microcomputers, and mainframe computers. Clearly, there is a close relationship between government planning and firms, especially those that are owned and directly aided by the government.

The heavy involvement of government in economic and social activities resulted in a large civil service with some 4.5 million workers.[21] Civil servants have advantages over private-sector workers: higher pay, shorter hours, more holidays, better pension, more bonuses, almost complete job security, and other perks. In France, in contrast to other European countries, the government workforce grew some 20 percent between 1979 and 1999 so that about one in four French workers received their pay from the government. It is no surprise then that many French people would like to become civil servants, or "functionaries."

Jean-Louis Barsoux and Peter Lawrence noted not only the close relationship between government and industry but also the impact of the elite universities, the Grandes Écoles, on forming the French managerial mind, which is considered essential for managing in both government and business organizations.[22]These schools supply the *cadre*, the managerial elite. Moreover, the schools' connections are vital for managerial success. What are valued in these managers are analytical ability, independence, and proficiency in synthesizing facts. While written communication is considered very important, oral communication is de-emphasized. These managers

exhibit intellectual ability rather than action. Rationality, problem solving, and numerical analysis are important for obtaining high managerial posts in government as well as in business. Indeed, it is not unusual for managers to work for both alternately.

The French managerial model also has drawbacks. It may limit managers in dealing with non-quantifiable and "non-rational" data and in responding quickly to changes in the environment, and it may not result in the selection of the best managers because school ties may be more important than performance. Although the managerial characteristics may also be limiting in terms of obtaining a global outlook, French managers, in general, are quite supportive of the European Union. They see it as an opportunity to restructure the New Europe.

## Germany: Authority and Codetermination

**Codetermination** requires labor membership in the supervisory board and the executive committee of the corporation.

In the past, and to a lesser extent today, the German cultural environment favored reliance on authority in directing the workforce, although it was often benevolent authoritarianism (managerial function of leading). Even today, while managers may show concern for subordinates, they also expect obedience. In 1951, a law was passed that provided for **codetermination**, which requires labor membership in the supervisory board and the executive committee of certain large corporations. Furthermore, a labor director is elected as a member of the executive committee. This position is a difficult one. Labor directors supposedly must represent the interests of the employees and, at the same time, must make managerial decisions that are in the best interest of the enterprise.

## Selected Factors Influencing Managing in Other Western Countries

Managing in Australia is influenced by the country's moralistic stance and its emphasis on political and social values, achievement, and risk taking.

Italian managers operate in an environment of low tolerance for risks. Italians are very competitive, but at the same time they like group decision-making.

Management in Austria (and Germany) is characterized by self-realization and leadership. Independence and competitiveness are valued. Tolerance for risk taking is rather low.

In Britain, job security is important, and so are resourcefulness, adaptability, and logic. Individualism is also highly valued.

LEADERSHIP PERSPECTIVE

### Is There a European Management Model?[23]

Managers in European countries manage in different ways. Yet there are some commonalities, as interviews with top managers from European firms found:

- European managers think of themselves as being more people-oriented than American managers are.

- A great deal of negotiation takes place within European firms, such as between management and workers or unions and between headquarters and subsidiaries. The practice of codetermination in large German firms may be an illustration of such extensive negotiations. European managers perceive the American style as more top-down.
- Europeans also have developed great skills in managing international diversity. Managing across borders is achieved more through people than through structures and procedures. The ability of most European managers to speak several languages facilitates the "people approach."
- European managers operate between the extremes of short-term profit orientation (of American managers, as perceived by European managers) and the long-term growth orientation of Japanese managers.

European managers, on the other hand, have adopted many managerial techniques from the Americans, and they also could learn from American entrepreneurship. In the global environment, with free flow of information and with MNCs operating in many countries, there may be some convergence of managerial approaches. ■■

## Korean Management

***Chaebol*** is characterized by a tight collusion between government and industrial conglomerates.

Japanese management receives a great deal of attention, partly because of the economic success of Japanese companies in the past. The Republic of Korea (South Korea, referred to here as Korea) has also shown remarkable economic growth, but the Asian economic crisis that began in 1997 resulted in a dramatic downturn of its economy. Korean management practices are not well known. It would be incorrect to assume that Korean management is simply an extension of Japanese management. It is not, although there are some cultural and structural similarities, such as the dominance of powerful conglomerate companies. The Korean model has been characterized by the ***chaebol***, a tight collusion between government and industrial conglomerates. However, Kim Young Sam, when he was the Korean President, suggested: "We need a better balance between big and small companies. We cannot just let the chaebol grow by taking over small businesses."[24] He even declared: "The chaebol system, which puts the emphasis on outward expansion that burdens the people, has come to an end."[25]

***Inhwa*** Korean concept of harmony.

In Japan, managers emphasize group harmony and cohesion expressed in the concept of *wa*; the Korean concept of ***inhwa*** also translates into harmony, but with less accent on group values. Korean organizations are quite hierarchical, with family members occupying key positions. Beyond blood relationships, the factors affecting hiring decisions often include the school attended or being from the same geographic region as the top person. The leadership style can best be described as top-down, or autocratic/paternalistic. This approach enables the firm to adjust quickly to demands in the environment by issuing commands. Lifetime employment does not prevail. Indeed, the labor turnover rates are high when compared with the low rates in Japan. Turnover is primarily attributable to resignations rather than dismissals. All

in all, Korean management is different from both Japanese and American management practices.

## Japanese Management and Theory Z

Japan, one of the leading industrial nations in the world, has adopted managerial practices that are quite different from those of other economically advanced countries in the Western world. The discussion here deals with two common Japanese practices: lifetime employment and consensus decision-making. Then it compares and contrasts Japanese and U.S. managerial practices, including Theory Z. In the closing sections of parts 2 to 6 of this book, other managerial practices in Japan are discussed and compared with those in the United States and China.

**Lifetime employment** Important features of Japanese management are lifelong employment for permanent employees (related to the managerial function of staffing), great concern for the individual employee, and emphasis on seniority.

***Wa*** Japanese concept of harmony.

Typically, employees spend their working life with a single enterprise, which in turn gives employees security and a feeling of belonging. This practice brings the culturally induced concept of ***wa*** (harmony) to the enterprise, resulting in employee loyalty and close identification with the aims of the company. However, it also adds to business costs because employees are kept on the payroll even when there is insufficient work. Consequently, firms are beginning to question this practice. Indeed, changes appear to be in the making, but they are slow. What is often overlooked, however, is that this permanent employment practice is used primarily by large firms. In fact, it is estimated that the job security system applies to only about one-third of the labor force.

INTERNATIONAL PERSPECTIVE

### Are Japanese Workers Happy?[26]

Japanese workers endured long working hours and sometimes poor working conditions in exchange for lifetime employment. While this practice still prevails in many companies, some companies do not provide their workers with a sufficient safety net of employment. This insecurity may have contributed to making Japanese workers the least satisfied among seven countries surveyed.

www.isrsurveys.com

A study conducted by International Survey Research found that the Japanese were the least satisfied and the Swiss workers the most satisfied. Specifically, in response to the question, "Taking everything into account, how satisfied are you with your company as an employer?" the following results were obtained:

In Switzerland 82 percent of the workers were satisfied, in Canada 73 percent, in Mexico 72 percent, in Germany 66 percent, in the United States 65 percent, in the United Kingdom 63 percent, and in Japan only 44 percent.

Moreover, only 33 percent of the Japanese workers felt that their company was managed well. Among the respondents, 60 percent felt that they were not fairly appraised; only 37 percent felt that their pay was fair.

The often admired disciplined Japanese workforce appears to think that their contributions to Japan's economic success have not been sufficiently recognized and rewarded, as shown by the low satisfaction of its workers. ■■

www.world.sony.com

Closely related to lifelong employment is the seniority system, which provides privileges for older employees who have been with the enterprise for a long time. But there are indications that this system may be superseded by a more open approach that provides opportunities for advancement for young people. For example, the relatively new Sony Corporation has team leaders (a point is made of not calling them supervisors) who are often young women 18 or 19 years of age. There is practically no age difference between these leaders and the operators they lead.

**Decision-making in Japan** The managerial practice of decision-making in Japan is also considerably different from that in the United States. It is built on the concept that new ideas and change should primarily come from below. Thus, lower-level employees prepare proposals for higher-level personnel. Supervisors, rather than simply accepting or rejecting the proposals, tactfully question them, make suggestions, and encourage subordinates. If necessary, proposals are sent back to the initiator for more information. Still, in major decisions, top management retains its power.

Japanese management, then, uses decision-making by consensus to deal with everyday problems. Lower-level employees initiate an idea and submit it to the next higher level, until it reaches the desk of the top executive. If the proposal is approved, it is returned to the initiator for implementation.

**Theory Z** The adaptation of selected Japanese managerial practices to the U.S. environment.

www.ibm.com

www.hp.com

**Theory Z** In Theory Z, selected Japanese managerial practices are adapted to the environment of the United States. This approach is practiced by companies such as IBM, Hewlett-Packard, and the diversified retail company Dayton-Hudson. One of the characteristics of Type Z organization, as suggested by Professor William Ouchi, is an emphasis on the interpersonal skills needed for group interaction.[27] Yet, despite the emphasis on group decision-making, responsibility remains with the individual (which is quite different from the Japanese practice, which emphasizes collective responsibility). There is also an emphasis on informal and democratic relationships based on trust. Yet the hierarchical structure remains intact, as illustrated by IBM, where not only goals but also authority, rules, and discipline guide corporate behavior.

## Rise of China: Deng Xiaoping Changed China from the Planned Economy towards a Market Economy[28]

Deng Xiaoping was a statesman, diplomat, and theorist. He has been credited with leading China from a planned economy to a market-driven economy that led to China's growth after the Cultural Revolution. He encouraged foreign investment and

allowed limited private investment which resulted that China became one of the fastest growing economies today. Deng's idea of moving toward a market economy was:

"Planning and market forces are not the essential difference between socialism and capitalism. A planned economy is not the definition of socialism, because there is planning under capitalism; the market economy happens under socialism, too. Planning and market forces are both ways of controlling economic activity." [29]

When Deng Xiaoping visited Singapore in 1978, he was impressed by the modern and technologically advanced nation that planned its economic development, built its infrastructure, and encouraged foreign investment. Deng considered Singapore's approach as the model for China resulting what has been called "socialism with Chinese characteristics." Combining the planning techniques with Singapore's developmental approach has resulted in economic growth rates around 9 percent in recent years and much of that can be attributed to the leadership of Deng Xiaoping. China began building new coal mines, modern power grids, nuclear power plants, new roads and highways, and other projects. Much of this development can be attributed to the leadership of Deng Xiaoping.

More recently, focus has risen on the increasing globalization of Chinese firms. As the Chinese economy has grown rapidly and taken on increased levels of technological sophistication, more of its firms (for example, Haier) have been able to compete on a global stage, internationalizing their value chain and expanding to new markets.[30]

## The Rise of India

India has grown by the dramatic reform beginning in 1991 which resulted in the reduction of bureaucracy. Many restrictions on imports were removed and exports were encouraged. India's business leadership contributed to that change especially in the high-tech area. One of those leaders is Narayana Murthy who by some is considered the Bill Gates of India. He and his colleagues started Infosys Consultants. The economic awakening of India was partly due to the perceived economic threat from China.

Another respected business leader is Ratan Tata who has had the challenging task of modernizing Tata Steel. Mr. Tata, an architect, educated in the United States is sometimes compared with Jack Welch of General Electric.[31] More recently, he gained prominence through the 2008 introduction of the $2,500 Nano car. Indian politicians now also look at the amazing economic developments in China. India is still far behind China in many areas, a country that learned from Singapore; now India looks towards China for ideas. One area that needs improvement is India's poor infrastructure which discouraged investments by foreign companies.

While China focused on manufacturing, India's strength is in the high technology area. While Bangalore is considered India's Silicon Valley, other cities have also moved into the technology sector. In Bangalore one can find many foreign multinationals such as Nokia, Intel, Philips, and General Electric.

While the changes in democratic India are fairly rapid, they are slow when compared with authoritarian China. [55] Reaching consensus with various interest groups takes time. Still, India today makes progress that could not have been imagined fifty years ago. The International Perspective provided highlights some of the differences between China and India.

INTERNATIONAL PERSPECTIVE

## A Comparison of China and India[32]

| China | India |
|---|---|
| Den Xiaoping's change, modernization ("socialism with Chinese characteristics") | 1991 Historic reforms began; Finance Minister (now Prime Minister) Manmohan Singh |
| Authoritarian government | Democratic government |
| Transformation | Same |
| Large population | Same |
| Development of middle class | Same |
| Planned and market driven economy | Increasingly market driven |
| Communism hindrance to expansion | Past colonialism hindrance |
| Focus on infrastructure | Poor infrastructure |
| Fast change because authoritarian direction | Slow consensus-requiring changes |
| Factory advantage | Back office advantage |
| Government by persuasion | Authoritarian government |
| High literacy rate | Low literacy rate |

INTERNATIONAL PERSPECTIVE

## Is China losing its Competitive Advantage? Opportunities for India[33]

For many years, China enjoyed a steady GDP growth of around 9 percent. Chinese manufacturers benefitted from low-cost labor, a cheap currency, and minimal regulations. However, things are beginning to change with higher labor and energy costs, cancelation of preferential policies, and an appreciation of the Chinese currency. Clothing, shoe, and toy factories in the Guangdong area had to close. Other companies in the Pearl River Delta experienced similar problems. Big multinational companies also reconsider their investment strategies. In an environment of globalization, firms are now considering leaving China and looking for opportunities in India and Vietnam. A German sportswear company is looking for opportunities in India where the costs are lower. However, productivity would probably lag in India.

The Chinese manufacturing environment is changing. New laws now require firms to provide benefits such as pensions. Moreover, employees are gaining

collective-bargaining rights. While many of the changes have benefitted labor, the middle class families have also been affected negatively by rising housing and other living expenses. For example, while the consumer price inflation was 4.8 percent in 2007, the beginning of 2008 was even more (7.1 to 8.7 percent in January and February 2008).

Due to the rising costs in cities and the coastal regions, companies now are looking at relocating to inner China as well as opportunities in Vietnam and India. ■■

## PORTER'S COMPETITIVE ADVANTAGE OF NATIONS[34]

Besides appreciating cultural differences in management style, managers should also understand the economic situations of other countries. Michael Porter, a Harvard Business School professor, questions the economic theory of comparative advantage. He suggests four sets of factors that contribute to a nation's well-being. The first set pertains to factor conditions such as a nation's resources, its labor costs, and the skills and education of its people. The second factor set consists of the demand conditions of a nation, such as the market size, the way products may be advertised, and the degree of consumer sophistication. The third set of factors concerns the suppliers: a company prospers when supporting companies are located in the same area. The fourth factor set consists of the firm's strategy and structure as well as rivalry among competitors.

A favorable combination of the four sets of factors leads to competitive advantage. When only two sets are favorable, competitive advantage usually cannot be sustained. On the other hand, the availability of resources is not always necessary. Japan, for example, lacks natural resources, yet the country prospered in the past. In fact, economic hardship may stimulate economic activity and success, as illustrated by Japan and Germany after World War II. However, these two countries have consumers who demand sophisticated products of high quality. Similarly, Japanese and German companies have good relationships with their suppliers. They also benefit from good education systems and a skilled labor force. Despite cooperation among Japanese companies on certain levels, they are also fiercely competitive.

**INTERNATIONAL PERSPECTIVE**

### General Motors's (GM) Expanse in India[35]

The automobile industry will be an important part in increasing the competitive advantage of India. Many car companies are investing in India as illustrated by General Motors. GM announced the opening of the second auto plant in India. This seems to indicate GM's strategy to expand in emerging markets. The company expects that India is going to be an important income source for the company in coming years. Although it ranks only fifth in sales in 2008, GM invested heavily in

the new plant in Talegaon near Pune and not far away from Mumbai. The plant is to produce the mini-car called Spark. The introduction of new cars is not sufficient, a supportive dealer and service network is required for success; therefore GM will expand this network. In addition, the company has a technical center in Bangalore where it employs engineers and designers. The Indian expansion, although small when compared with China, seems to indicate that GM sees India as an opportunity for its Asian expansion. ■■

## GAINING A GLOBAL COMPETITIVE ADVANTAGE THROUGH QUALITY MANAGEMENT

Quality has become a strategic weapon in the global marketplace. American companies, once the acknowledged world leaders in productivity, have become under siege from firms around the globe. One reason is that many American companies became complacent and failed to see the changing needs of the global market, which increasingly demanded quality products. This complacency and the lack of foresight enabled competitors, especially those from Japan, to use a powerful weapon to increase their market shares in the U.S. and European markets. This weapon is quality.

Before managers can revolutionize the production process, they must first revolutionize the way they think about quality. The need for a new philosophy of quality is paramount. The old philosophy of adequacy—maintaining the status quo for as long as a product turns a profit—is no longer acceptable. Now the aim of companies must be nothing short of excellence. To attain excellence, however, managers must be willing to put the needs of their customers first. They must never forget that customers are indispensable: they are the reason the company exists.

### Traditional Quality Management Gurus[36]

Although the concern for quality may seem like a recent phenomenon, there were several quality gurus who tried to introduce their theories to American companies in the 1950s. But U.S. managers did not listen. This, however, is beginning to change. In fact, early quality management pioneers have now been joined by many new advocates of quality. We will briefly review the contributions of three quality champions: Deming, Juran, and Crosby. Each has taken a different approach to quality management, yet each has helped to shape its direction.

There are several interesting parallels between the career paths of the two American professors: Dr. Deming and Dr. Juran. Both men taught in the business department at New York University in the 1950s. During the post–World War II economic boom, Deming and Juran made unsuccessful attempts to persuade American managers to focus on quality. When Americans ignored their teachings, the two scholars decided to take their message to a more receptive audience—the Japanese.

Their pilgrimage to Japan could not have occurred at a more favorable time. Before the 1950s, Japan's export trade suffered because their domestic goods had a reputation for shoddy workmanship and inferior quality. Japanese-made cars, for

example, were poorly designed and manufactured, were unreliable, and featured unattractive styling. With such a combination of undesirable product features, it is not surprising that American consumers were uninterested in Japanese-made vehicles.

But over the last three decades, Japanese auto makers have steadily captured a market share in the United States by selling quality cars. This transformation from inferior to superior quality was, to a great extent, made possible by the teachings of Deming and Juran. They helped to revolutionize the quality of Japan's industries, and they have become the quality heroes. Partly because of their work, consumers all over the world now equate Japanese products with high quality. As a tribute to his contributions, the most coveted quality award in Japan is named in honor of the late Dr. Deming. Today, many years after Deming and Juran showed Japanese managers how to produce quality products, they are finally getting some much-deserved attention from American managers.

The last of this trio of quality gurus is Phil Crosby. Unlike Deming and Juran, Crosby did not cross the Pacific to instruct the Japanese, nor did his approach originate within the university setting. Crosby was not an academic. He formulated practical ideas for improving quality while working in a variety of U.S. corporations. His hands-on style enabled him to put his ideas into action at Martin Marietta and ITT, where he worked before becoming a corporate consultant.

www.deming.org
www.juran.com
www.philip-crosby.com

While all three experts—Deming, Juran, and Crosby—view quality as an imperative for survival, each of them defines quality differently. For Deming, quality meant providing customer-satisfying products and services at a low cost. It also meant a commitment to continual innovation and improvement that the Japanese call *kaizen*. For Juran, a key element in the definition of quality is a product's "fitness for use." Finally, Crosby explains quality from an engineering perspective as the conformance to precise standards and requirements. His motto is "Do it right the first time [and] achieve zero defects." All three experts consider statistics a valuable tool for measuring quality, although Deming is perhaps the best known for commitment to statistical analysis.

## Other Quality Approaches and Awards[37]

As mentioned earlier, the Deming Award recognizes companies that have achieved superior quality in Japan. A similar award, but one with a different emphasis, is the Malcolm Baldrige National Quality Award established by the U.S. Congress in 1987. Another approach is known as ISO 9000, pioneered by the Europeans. There is also the European Quality Award given by the European Foundation for Quality Management.[38]

www.quality.nist.gov

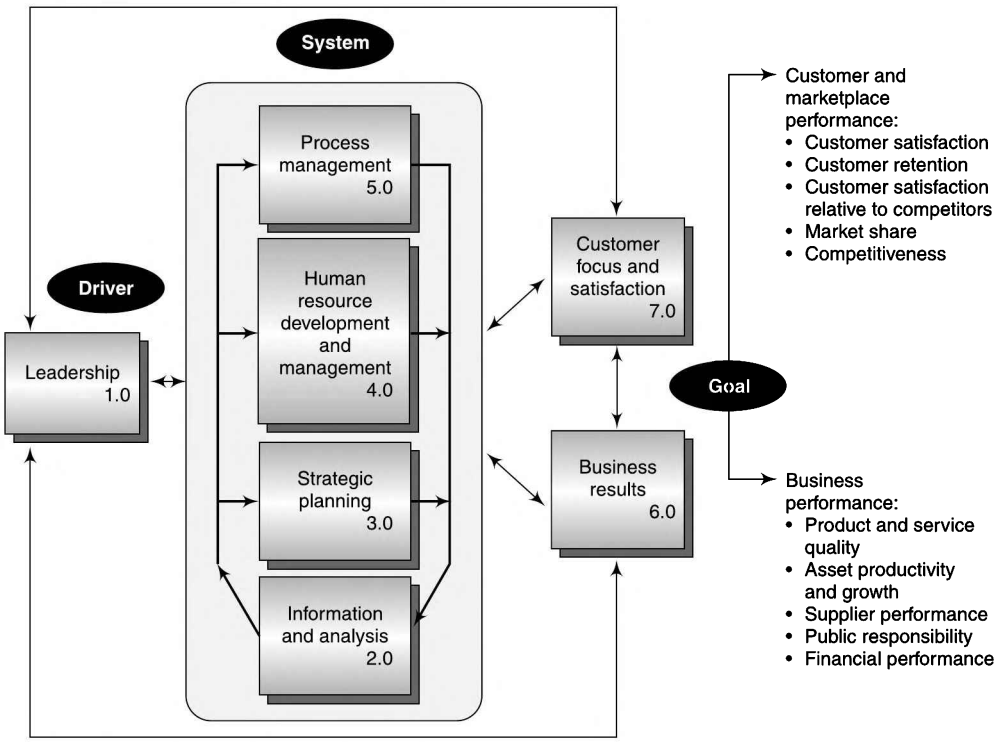
**Malcolm Baldrige National Quality Award 1996[39]** The Malcolm Baldrige award is the highest national recognition a U.S. company can receive for business excellence. The award helps the understanding of performance requirements of excellence and competitiveness. The three categories for participation are (1) manufacturing firms, (2) service companies, and (3) small businesses. Applicants for the award are expected to share information about the company's improvement processes and the results so that this information can be used by other organizations. Each company benefits by getting feedback from the examiners.

Participants in the award program must show results and improvements in a variety of areas. Specifically, the criteria are grouped into seven categories with 24 items. The assessment, however, is tailored to the requirements of key success factors of the specific company, depending on the kind of business, its size, its strategy, and its stage of development. The seven categories, illustrated in Figure 3.2, are as follows:[40]

1. The *leadership* category requires that senior executives set direction and build and maintain the leadership required for high performance. This criterion also demands leadership in creating an effective organization and management system as well as demonstrating public responsibility and corporate citizenship.
2. The *information and analysis* category examines the company's effectiveness and use of management information (financial and nonfinancial). It not only requires the analysis of company data but also includes competitive analysis and benchmarking, comparing performance with the best firms.
3. *Strategic planning* includes business planning with an emphasis on translating the plans into customer and operational requirements. Planning has to be driven by customer needs and operational improvement.

**Figure 3.2**

**The Baldrige Award Criteria Framework: Dynamic Relationships.**




*Source:* Malcolm Baldrige National Quality Award 1996 Award Criteria (Gaithersburg, MD: U.S. Department of Commerce, Technology Administration, National Institute of Standards and Technology, undated).

4. The category of *human resource development and management* includes criteria for all key aspects of human resources.
5. *Process management* focuses on all key work processes, including the design, introduction, production, and delivery of products and services. It also includes criteria for support services and supplier performance.
6. Organizations are results-oriented. This category looks at *results*: quality results in products and services as well as company operational and financial results; it also includes human resource and supplier performance results.
7. The final category is *customer focus and satisfaction*. Specifically, the criteria in this category require excellence in customer and market knowledge, relationships with customers, and customer satisfaction compared with that of the firm's competitors.

The award criteria focus on business results. They are nonprescriptive, which means the requirements can be met in a variety of ways. As shown in the seven categories, the criteria are comprehensive, involving interrelated processes and results that focus on improvement and continuous learning. They also emphasize a systems approach in which all parts of the organization are aligned with each other. Moreover, the criteria serve as a diagnostic tool, pointing out the strengths and weaknesses of the company.

The award criteria are not static but evolve toward a comprehensive system. For example, the 1996 award criteria discussed above had a new "business results" category added. At any rate, the Malcolm Baldrige award is designed to make U.S. companies more competitive in the global environment. Its criteria are congruent with the discussions in this book.

www.iso.ch

**ISO 9000**[41] ISO 9000 has become so popular that some have termed it ISO-mania. ISO, which is derived from the Greek *isos*, meaning equal, was founded in 1946 in Geneva, Switzerland. The ISO 9000 document was first published in 1987 and consists actually of five related standards numbered from 9000 to 9004 (and expanding). Although the ISO movement originated in Europe, now more than 100 countries participate in ISO, including Japan, the United States, and European Union nations. Most large companies, such as General Electric, Du Pont, British Telecom, and Philips Electronic, urge and even demand suppliers to be ISO 9000 certified.

ISO 9000 requires that the company document its processes and quality system, assure that all employees understand and follow the guidelines of the document, continually monitor and check the quality system through internal and external audits, and make any necessary changes. The internal benefits of ISO 9000 are the documentation of processes, a greater quality awareness of the company's employees, a possible change in organization culture resulting in increased productivity, and the installation of an overall quality system. The external benefits include an advantage over non-registered competitors, meeting the requirements set forth by customers and the European Union, higher perceived quality and possible greater customer satisfaction, and meeting, for example, the demands of purchasing agents.

The Malcolm Baldrige award and ISO 9000 differ in focus, purpose, and content. ISO 9000 focuses on the adherence to the practices specified by the company. Its purpose is to assure buyers that certain practices and documentation are in confor-

mance with the quality system identified by the firm. ISO 9000 does not evaluate the efficiency of the operation, nor improvement trends, nor the product quality. It does not ensure quality products or services, does not emphasize continuous improvement, and is not concerned with empowerment or teamwork. But ISO 9000 does provide the documentation to show customers how the company trains employees, tests its products, and corrects problems. Purchasing agents like to see proof that the registered company has a documented quality system and follows it. Documentation is a central aspect of ISO 9000. Therefore, ISO registration cannot be compared with Baldrige award scores.

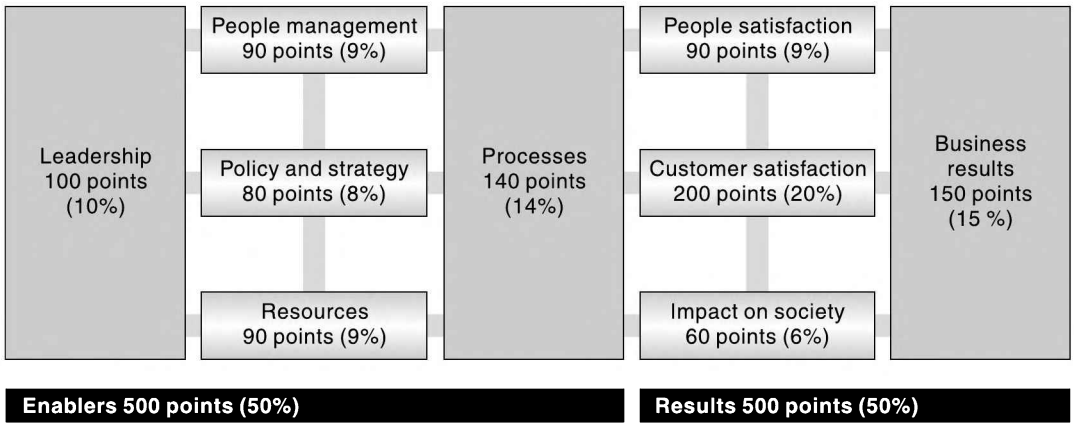
www.efqm.org

**European Model for Total Quality Management** Another quality program is the European Quality Award bestowed upon excellent companies by the European Foundation for Quality Management (EFQM).[42] The 1996 European model for total quality management, as shown in Figure 3.3, is built on the following premise: "Customer Satisfaction, People (employee) Satisfaction, and Impact on Society are achieved through Leadership driving Policy and Strategy, People Management, Resources and Processes, leading ultimately to excellence in Business Results."[43] The percentages shown in the figure are used for assigning weights in the award.

**Figure 3.2**

**The European Foundation for Quality Management Model for Business Excellence.**

**Used with permission. "The EFQM Model for Business Excellence," in "Self-Assessment 1997 Guidelines for Companies (Brussels: European Foundation for Quality Management, 1997) p. 8.**




The European total quality management model is built on the American Baldrige award but contains some new aspects, as a comparison of the two models reveals. Still, the models are very similar. For example, the "impact on society" variable in the European model is considered in the "leadership" concept of the Baldrige award as "public responsibility and corporate citizenship." Similarly, "people satisfaction" in the European model is part of "human resource development and management"

in the Baldrige model. What is interesting in the European model is that the first five variables (leadership, people management, policy and strategy, resources, and processes) are called "enablers." This means that they deal with *how* an organization achieves the results. The four other criteria (people satisfaction, customer satisfaction, impact on society, and business results) are called "results" and deal with *what* an organization has achieved.

In conclusion, then, the American Malcolm Baldrige National Quality Award model and the European model for total quality management are similar, but both are very different from ISO 9000.

## SUMMARY

International businesses, which extend their operations across national boundaries, are particularly affected by the educational, sociocultural–ethical, political–legal, and economic environments of the host countries. Multinational corporations have developed different orientations for operating in foreign countries, ranging from ethnocentric (the foreign operation's views are based on those of the parent company) to geocentric (the organization is viewed as an interdependent system operating in many countries, that is, it is truly international).

Countries are forming regional alliances, such as the European Union, NAFTA, ASEAN, and Mercosur. Hofstede studied the impact of a country's culture on the behavior of its people.

Managerial practices differ between countries. In France, for example, government planning greatly influences the planning and direction of enterprises. In Germany, the use of authority and the concept of codetermination shape managerial practices. South Korea has developed managerial practices that are different from those in Japan and the United States. Japanese managerial practices differ greatly from those in the United States. Theory Z, which involves selected Japanese managerial practices, has been adopted by some U.S. companies.

International business managers also need to understand the economic situations of other countries. Porter identified four sets of factors that contribute to the competitive advantage of a nation.

Quality is a strategic weapon in the global marketplace. The traditional contributors to quality management are Deming, Juran, and Crosby. The Malcolm Baldrige National Quality Award recognizes U.S. organizations for their excellent performance. The European quest for quality is exemplified by ISO 9000 and the European Quality Award.

## KEY IDEAS AND CONCEPTS FOR REVIEW

- ✔ International business
- ✔ Exportation
- ✔ Licensing
- ✔ Management contract
- ✔ Joint venture
- ✔ Subsidiary
- ✔ Multinational Corporation
- ✔ Ethnocentric orientation

- ✔ Polycentric orientation
- ✔ Regiocentric orientation
- ✔ Geocentric orientation
- ✔ Global or transnational corporation
- ✔ Country alliance and trade bloc
- ✔ Hofstede's five dimensions of behavior
- ✔ Management practices in France, Germany, and South Korea
- ✔ Management practices in Japan and Theory Z
- ✔ Comparison of China with India
- ✔ Porter's competitive advantage of nations
- ✔ Contributions to quality management by Deming, Juran, and Crosby
- ✔ Malcolm Baldrige National Quality Award criteria
- ✔ ISO 9000
- ✔ European Quality Award model

## FOR DISCUSSION

1. What advantages do multinational corporations have? What challenges must they meet? Give examples.
2. What are the five cultural dimensions identified by Hofstede?
3. What are some key characteristics of French, German, Korean, and Japanese management practices?
4. What is Theory Z?
5. Do you think the managerial concepts and practices applied in the United States can be transferred to Britain, France, Germany, or any other country that you know?
6. Take any country with which you are familiar and discuss how factors in the educational environment impact on managing an enterprise.
7. Discuss how a company with a geocentric orientation may manage. Compare these practices with a company having an ethnocentric outlook.
8. Do you think that the way managerial decisions are made in Japan could work in the United States? Why or why not?
9. From the various approaches to quality management, which model do you find most useful? Why?

## EXERCISE/ACTION STEPS

Interview the managers of a company that is known for excellent products or services. Ask how they achieved the high level of quality.

## INTERNET RESEARCH

1. Search the Internet for Geert Hofstede and identify his articles and books. Discuss the cultural characteristics of any three countries.

2. Use the Internet to find out the economic conditions of the Eastern European countries that have been admitted to the European Union. Select one country to discuss in detail.

## Leadership Case — Starbucks—The Leadership of Howard Schultz[44]

Starbucks was started in 1971 by three academicians in Seattle. Ten years later, Howard Schultz joined the company. During his trip to Italy he realized that the coffee house can be much more that simple a place where you drink coffee. However, his ideas were not accepted by the owners of the company. Being frustrated, Howard Schultz looked for investors and eventually bought the company. From 1987 until 1992, Starbucks remained a privately-held company. When the company ventured outside the Pacific Northwest, the company first experienced disappointments which were followed by mixed to moderate successes.

Howard's dream was to not only provide a friendly environment for its customers, but also for its employees providing friendly service. This meant taking good care of its employees by providing healthcare benefits not only for its full-time employees, but also for those working 20 hours or more. Moreover, employees could also purchase stocks in the company. In all, company pay and benefits attracted motivated employees with good skills.

Starbucks' aim was "to build a company with soul." This meant that employees had to listen carefully to what customers want and meet their expectations. The customer-oriented philosophy was expressed in the mission statement which also emphasized that employees treating each other with dignity, enjoying diversity in the workplace, reflecting the local community, having high standards for coffee, being a good member of the community, and being, of course, profitable.

The mission statement resulted in strategies that lead not only to domestic, but also international expansion. In 2006, the Starbucks website showed 16 international countries plus Beijing, Shanghai, and Hong Kong. The longer range goal was to have some 25,000 stores in various locations. To achieve this long range aim, Starbucks designed stores with a pleasant ambiance which customers, surrounded by coffee aroma, really enjoy. Also, since 2002, the company worked with T-Mobile USA by providing Internet access in the coffee shops. Besides offering caffeinated and decaffeinated beverages, a great variety of specialty coffees as well as teas are offered. Customers can also get juices, pastries, coffee mugs, coffee-making equipment, and even CDs. Moreover, Starbucks partnered with PepsiCo and Dreyer's Grand Ice Cream and engaged in licensing agreements with Kraft Foods. Coffee is also offered at warehouse clubs, Marriott Host International, United Airlines, and even at Wells Fargo Bank. Catalog sales were tried but did not succeed and consequently were discontinued. Starbucks also invested unsuccessfully in a number of dot.com companies.

The sense of social responsibilities guided the company's actions. Not only did the firm participate in local charities to "give back" to the community in which it operates, but also applied this sense of responsibility to its purchasing practices. Most of its retail stores and hotels with which the company had licensing agreements, used Fair Trade Certified coffee.[45]

Clearly, the company has been successful despite competition from coffee makers such as Proctor & Gamble, Nestle, and Kraft General Foods. How, then, will Starbucks meet those and other challenges in the future?

**Questions**

1. Why was Starbucks so successful?
2. How does Starbucks differ from other coffee houses?
3. How could the company attract non-coffee drinkers?
4. What other challenges may Starbucks encounter in the future?

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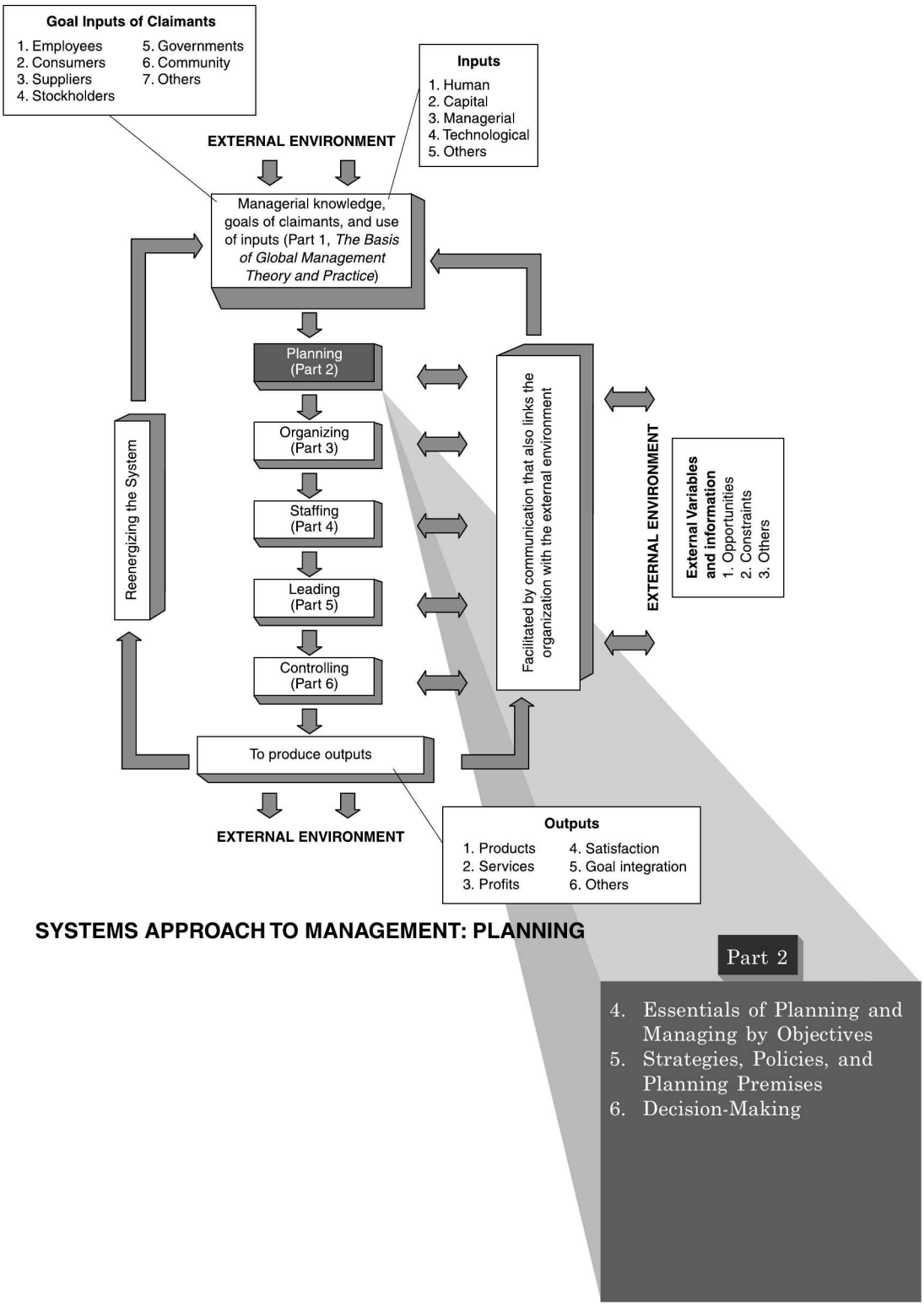

Goal Inputs of Claimants
1. Employees
2. Consumers
3. Suppliers
4. Stockholders
5. Governments
6. Community
7. Others
Inputs
1. Human
2. Capital
3. Managerial
4. Technological
5. Others
EXTERNAL ENVIRONMENT
Managerial knowledge, goals of claimants, and use of inputs (Part 1, The Basis of Global Management Theory and Practice)
Planning (Part 2)
Organizing (Part 3)
Staffing (Part 4)
Leading (Part 5)
Controlling (Part 6)
To produce outputs
Reenergizing the System
Facilitated by communication that also links the organization with the external environment
EXTERNAL ENVIRONMENT
External Variables and information
1. Opportunities
2. Constraints
3. Others
EXTERNAL ENVIRONMENT
Outputs
1. Products
2. Services
3. Profits
4. Satisfaction
5. Goal integration
6. Others
SYSTEMS APPROACH TO MANAGEMENT: PLANNING
Part 2
4. Essentials of Planning and Managing by Objectives
5. Strategies, Policies, and Planning Premises
6. Decision-Making

# 4 Essentials of Planning and Managing by Objectives

## CHAPTER OBJECTIVES

After studying this chapter, you should be able to:

- Understand what managerial planning is and why it is important
- Identify and analyze the various types of plans and show how they relate to one another
- Outline and discuss the logical steps in planning and see how these steps are essentially a rational approach to setting objectives and selecting the means of reaching them
- Explain the nature of objectives
- Describe how verifiable objectives can be set for different situations
- Outline the evolving concepts in management by objectives (MBO)
- Understand the model of the systems approach to MBO
- Describe the benefits of MBO
- Recognize the weaknesses of MBO and suggest ways to overcome them

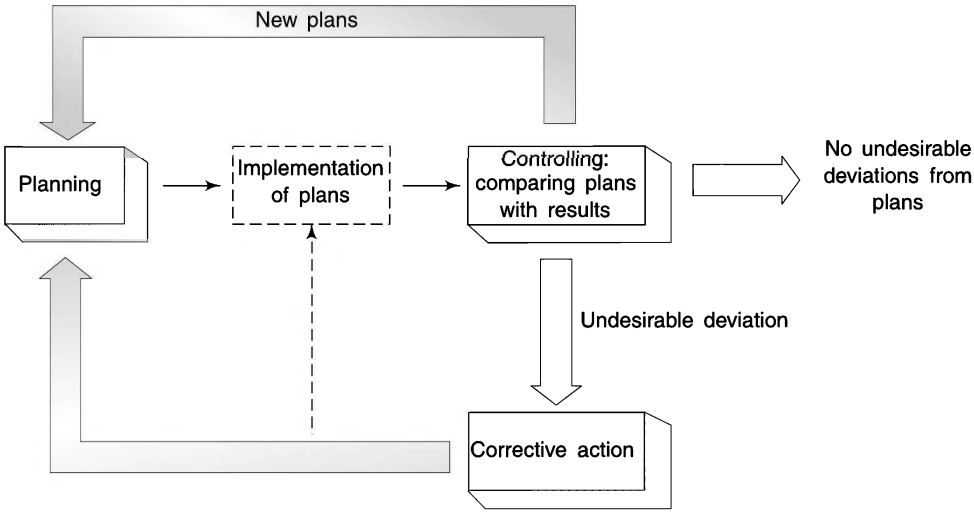
You are now familiar with the basic management theory and have been introduced to the five essential managerial functions: planning, organizing, staffing, leading, and controlling. In Part 2 of this book, we shall discuss planning.

**Planning** Selecting missions and objectives as well as the actions to achieve them, which requires decision-making, that is, choosing a course of action from among alternatives.

In designing an environment for the effective performance of individuals working together in a group, a manager's most essential task is to see that everyone understands the group's mission and objectives and the methods for attaining them. If group effort is to be effective, people must know what they are expected to accomplish. This is the function of planning. It is the most basic of all the managerial functions. **Planning** involves selecting missions and objectives and deciding on the actions to achieve them; it requires decision-making that is, choosing a course of action from among alternatives. Plans thus provide a rational approach to achieving pre-selected objectives. Planning also strongly implies managerial innovation, as will be discussed in Chapter 6. Planning bridges the gap from where we are to where we want to go. It is also important to point out that planning and controlling are inseparable—the Siamese twins of management (see Figure 4.1). Any attempt to control without plans is meaningless, since there is no way for people to tell whether they are going where they want to go (the result of the task of control) unless they

**Figure 4.1**

**Close Relationship of Planning and Controlling.**






first know where they want to go (part of the task of planning). Plans thus furnish the standards of control.

## TYPES OF PLANS

Plans can be classified as (1) missions or purposes, (2) objectives or goals, (3) strategies, (4) policies, (5) procedures, (6) rules, (7) programs, and (8) budgets.

### Missions or Purposes*

**Mission or purpose** The basic purpose or function or tasks of an enterprise or agency or any part of it.

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The **mission** or **purpose** (the terms are often used interchangeably),[1] identifies the basic purpose or function or tasks of an enterprise or agency or any part of it. Every kind of organized operation has, or at least should have if it is to be meaningful, a mission or purpose. In every social system, enterprises have a basic function or task assigned to them by society. For example, the purpose of a business generally is the production and distribution of goods and services. The purpose of a state highway department is the design, building, and operation of a system of state highways. The purpose of the courts is the interpretation of laws and their application. The purpose of a university is teaching, research, and providing services to the community.

Although we do not do so, some writers distinguish between mission and purpose. While a business, for example, may have a social purpose of producing and distributing goods and services, it can accomplish this by fulfilling a mission of producing

*Often the term *vision* is mentioned in connection with the discussion of mission. Popular books on management discuss concepts such as goal setting, team management, and orientation toward the future, in connection with the discussion of vision.

certain lines of products. The mission of an oil company, like Exxon, is to search for oil and to produce, refine, and market petroleum and petroleum products, from diesel fuel to chemicals. The mission of Du Pont has been expressed as "better things through chemistry," and Kimberly-Clark (noted for its Kleenex trademark) regards its business mission as the production and sale of paper and paper products. In the 1960s, the mission of the National Aeronautics Space Administration (NASA) was to get a person to the moon before the Russians. It is true that in some businesses and other enterprises, the purpose or mission often becomes fuzzy. For example, many conglomerates have regarded their mission as **synergy**,* which is accomplished through the combination of a variety of companies.

## Objectives or Goals

**Objectives or goals** The ends toward which activity is aimed.

**Objectives** or **goals** (the terms are used interchangeably in this book), are the ends toward which activity is aimed. They represent not only the end point of planning but also the end toward which organizing, staffing, leading, and controlling are aimed. The nature of objectives and management by objectives will be discussed in greater detail later in this chapter.

## Strategies

**Strategy** The determination of the basic long-term objectives of an enterprise and the adoption of courses of action and allocation of resources necessary to achieve these goals.

For years, the military used the word *strategies* to mean grand plans made in light of what it was believed an adversary might or might not do. While the term still usually has a competitive implication, managers increasingly use it to reflect broad areas of an enterprise's operation. In this book, **strategy** is defined as the determination of the basic long-term objectives of an enterprise and the adoption of courses of action and allocation of resources necessary to achieve these goals.

## Policies

**Policies** General statements or understandings that guide or channel thinking in decision-making.

**Policies** also are plans in that they are general statements or understandings that guide or channel thinking in decision-making. Not all policies are "statements"; they are often merely implied from the actions of managers. The president of a company, for example, may strictly follow—perhaps for convenience rather than as policy—the practice of promoting from within; the practice may then be interpreted as policy and carefully followed by subordinates. In fact, one of the problems of managers is to make sure that subordinates do not interpret as policy minor managerial decisions that are not intended to serve as patterns.

Policies define an area within which a decision is to be made and ensure that the decision will be consistent with and contribute to an objective. Policies help decide issues before they become problems, make it unnecessary to analyze the same situation every time it comes up, and unify other plans, thus permitting managers to delegate authority and still maintain control over what their subordinates do.

*The concept of synergy can be expressed simply as a situation in which 2 plus 2 becomes equal to 5, or in which the whole is greater than the sum of the parts.

There are many types of policies. Examples include policies of hiring only university-trained engineers, encouraging employee suggestions for improved cooperation, promoting from within, conforming strictly to a high standard of business ethics, setting competitive prices, and insisting on fixed, rather than cost-plus, pricing.

## Procedures



**Procedures** Plans that establish a required method of handling future activities.

**Procedures** are plans that establish a required method of handling future activities. They are chronological sequences of required actions. They are guides to action, rather than to thinking, and they detail the exact manner in which certain activities must be accomplished. For example, Case Western University in Cleveland, Ohio outlines three steps for its appraisal process: (1) setting performance objectives, (2) performing a mid-year review of the objectives, and (3) conducting a performance discussion at the end of the period.[2] Procedures often cut across departmental lines. For example, in a manufacturing company, the procedure for handling orders may involve the sales department (for the original order), the finance department (for acknowledgment of receipt of funds and for customer credit approval), the accounting department (for recording the transaction), the production department (for the order to produce the goods or the authority to release them from stock), and the shipping department (for determination of shipping means and route).[3]

A few examples illustrate the relationship between procedures and policies. Company policy may grant employees vacations; procedures established to implement this policy will provide for scheduling vacations to avoid disruption of work, setting rates of vacation pay and methods for calculating them, maintaining records to ensure each employee of a vacation, and spelling out the means for applying for leave.

## Rules

**Rules** spell out specific required actions or nonactions, allowing no discretion.

**Rules** spell out specific required actions or nonactions, allowing no discretion. They are usually the simplest type of plan. "No smoking" is a rule that allows no deviation from a stated course of action. The essence of a rule is that it reflects a managerial decision that a certain action must—or must not—be taken. Rules are different from policies in that policies are meant to guide decision-making by marking off areas in which managers can use their discretion, while rules allow no discretion in their application.

**INTERNATIONAL PERSPECTIVE**

### Procedures and Rules Imposed by the Outside

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At times, rules and procedures are set up because of unfavorable publicity. General Dynamics, one of the largest US defense contractors, had been accused of improprieties.[4] In order not to be suspended from bidding on defense contracts, the company had to agree to a list of rules and procedures imposed by the U.S. Defense Department.

These new requirements were designed to prevent the shifting of costs from one contract to another. For example, workers have to prepare and sign their own time cards. The supervisor has to check each card; if one is incorrectly filled, the worker involved has to make the correction, which then has to be initiated by the worker and the boss. The original entry must not be erased so that it can be checked later. Also, General Dynamics was required to establish tight rules for charging overhead expenses. Employees are not allowed to accept gifts—not even a pen or a calendar.

Thus, rules and procedures can be imposed by an important customer and are examples not only of planning but also of controlling, showing the close relationship between the two functions. ■■

### Programs

**Program** A complex of goals, policies, procedures, rules, task assignments, steps to be taken, resources to be employed, and other elements necessary to carry out a given course of action.

**Programs** are a complex of goals, policies, procedures, rules, task assignments, steps to be taken, resources to be employed, and other elements necessary to carry out a given course of action; they are ordinarily supported by budgets. They may be as major as an airline's program to acquire a $400 million fleet of jets or a five-year program to improve the status and quality of its thousands of supervisors. Or they may be as minor as a program formulated by a single supervisor to improve the morale of workers in the parts manufacturing department of a farm machinery company.

### Budgets

**Budget** A statement of expected results expressed in numerical terms.

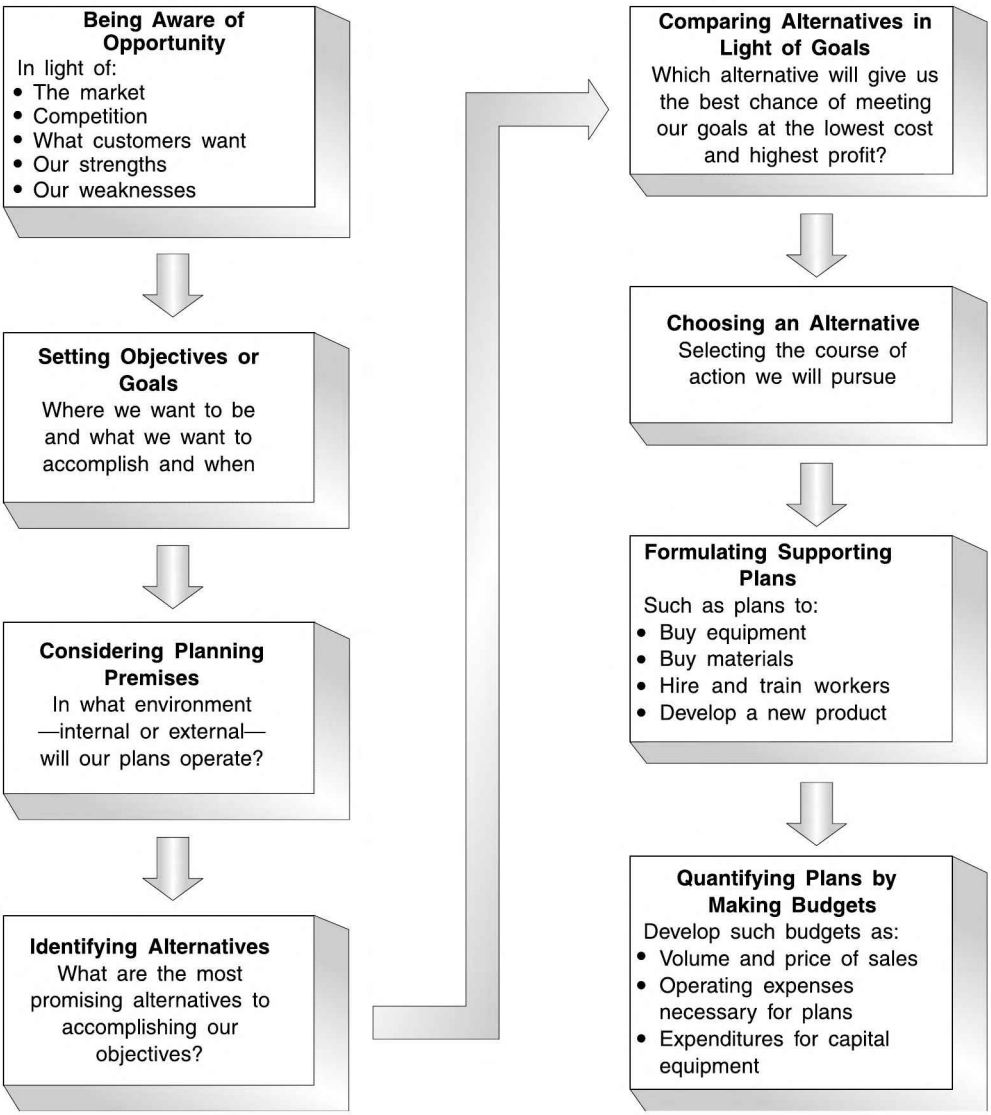
A **budget** is a statement of expected results expressed in numerical terms. It may be called a "quantified" plan. In fact, the financial operating budget is often called a *profit plan*. A budget may be expressed in financial terms; in terms of labor-hours, units of product, or machine-hours; or in any other numerically measurable terms. It may deal with operation, as the expense budget does; it may reflect capital outlays, as the capital expenditure budget does; or it may show cash flow, as the cash budget does. One of the most comprehensive budgets is prepared by the Office of Management and Budget of the White House.[5] The budget proposal is then presented to the Congress by the President of the United States.

Since budgets are also control devices, we reserve our principal discussion of them for Chapter 19 on control techniques. However, making a budget is clearly planning. The budget is the fundamental planning instrument in many companies. It forces a company to make in advance—whether for a week or for five years—a numerical compilation of expected cash flow, expenses and revenues, capital outlays, or labor- or machine-hour utilization. The budget is necessary for control, but it cannot serve as a sensible standard of control unless it reflects plans.

## STEPS IN PLANNING

The practical steps listed below, and diagramed in Figure 4.2, are of general application. In practice, however, one must study the feasibility of possible courses of action at each stage.

**Figure 4.1**
**Steps in Planning.**






## 1. Being Aware of Opportunities

Although it precedes actual planning and is therefore not strictly a part of the planning process, an awareness of opportunities* in the external environment as well as

*The word *problems* might be used instead of *opportunities*. However, a state of disorder or confusion and a need for a solution to achieve a given goal can more constructively be regarded as an opportunity. In fact, one very successful and astute company president does not permit his colleagues to speak of problems; they must speak only of opportunities.

within the organization is the real starting point for planning. All managers should take a preliminary look at possible future opportunities and see them clearly and completely, know where their company stands in light of its strengths and weaknesses, understand what problems it has to solve and why, and know what it can expect to gain. Setting realistic objectives depends on this awareness. Planning requires a realistic diagnosis of the opportunity situation.

## 2. Establishing Objectives

The second step in planning is to establish objectives for the entire enterprise and then for each subordinate work unit. This is to be done for the long term as well as for the short range. Objectives specify the expected results and indicate the end points of what is to be done, where the primary emphasis is to be placed, and what is to be accomplished by the network of strategies, policies, procedures, rules, budgets, and programs.

Enterprise objectives give direction to the major plans, which, by reflecting these objectives, define the objective of every major department. Major departmental objectives, in turn, control the objectives of subordinate departments, and so on down the line. In other words, objectives form a hierarchy. The objectives of lesser departments will be more accurate if subdivision managers understand the overall enterprise objectives and the derivative goals. Managers should also have the opportunity to contribute ideas for setting their own goals and those of the enterprise.

**Premises** Assumptions about the environment in which the plan is to be carried out.

**Principle of planning premises** The more thoroughly individuals charged with planning understand and agree to utilize consistent planning premises, the more coordinated enterprise planning will be.

## 3. Developing Premises

The next logical step in planning is to establish, circulate, and obtain agreement to utilize critical planning premises such as forecasts, applicable basic policies, and existing company plans. **Premises** are assumptions about the environment in which the plan is to be carried out. It is important for all the managers involved in planning to agree on the premises. In fact, the major **principle of planning premises** is this: the more thoroughly individuals charged with planning understand and agree to utilize consistent planning premises, the more coordinated enterprise planning will be.

Forecasting is important in premising: What kinds of markets will there be? What volume of sales? What prices? What products? What technical developments? What costs? What wage rates? What tax rates and policies? What new plants? What policies with respect to dividends? What political or social environment? How will expansion be financed? What are the long-term trends?

**LEADERSHIP PERSPECTIVE**

### Planning Hurdles for the $2,500 Nano Car[6]

When the $2,500 TATA's Nano car was introduced at the Delhi auto show in 2008, it caused headlines around the world. It also caught the attention of competitors such as Hyundai Motor and Nissan-Renault who plan to introduce low-priced cars.

The 50 miles per gallon car is expected to change the way Indian people travel. However, since the planning of the Nano, costs have risen. Raw materials, which constitute a substantial part of the cost, have risen in price. Also, the factory is behind schedule. Moreover, people around the plant near Kolkata have protested about the way government has seized their land without adequate compensation in order to build the factory.

The car's introduction comes at a time TATA Motors' earnings fell in mid 2008s. The company's stock price was also hurt, partly because of the acquisition of Jaguar and Land Rover from Ford Motor Company. Still, Ratan TATA is committed to the low-cost car project, although some compromises may have to be made to keep the price low.

Perhaps the greatest obstacle is the land disputes. Some 40,000 protesters descended on Singur, a city some 25 miles outside Kolkata, complaining that the state authorities together with the industrialists took some 1,000 acres from the farmers to build the Nano factory.[7] Tata, in return, threatened to move the factory out of the state. Indeed, in 2008 the company decided to relocate to the business friendly state of Gujarat.[8] The relocation could be very costly for Tata and also could delay the introduction of the Nano car. ■■



## 4. Determining Alternative Courses

The fourth step in planning is to search for and examine alternative courses of action, especially those not immediately apparent. There is seldom a plan for which reasonable alternatives do not exist, and quite often an alternative that is not obvious proves to be the best.

The more common problem is not finding alternatives but reducing the number of alternatives so that the most promising may be analyzed. Even with mathematical techniques and the computer, there is a limit to the number of alternatives that can be thoroughly examined. The planner must usually make a preliminary examination to discover the most fruitful possibilities.

## 5. Evaluating Alternative Courses

After seeking out alternative courses and examining their strong and weak points, the next step is to evaluate the alternatives by weighing them in light of premises and goals. One course may appear to be the most profitable but may require a large cash outlay and have a slow payback; another may look less profitable but may involve less risk; still another may better suit the company's long-range objectives.

There are so many alternative courses in most situations and so many variables and limitations to be considered that evaluation can be exceedingly difficult. Due to these complexities, the newer methodologies and applications and analysis are discussed in Part 6 on controlling.

INTERNATIONAL PERSPECTIVE

### Evaluating Alternative Courses for the Indian Auto Makers to Mitigate the Environmental Impact[9]

India is well known for its motorcycles. Hindustan Motors is known for its traditional Ambassador. But with the introduction of TATA's $2,500 Nano, the industry got international limelight. Many car companies have entered India. For example, General Motors build its second plant in India in 2008. GM will compete with Maruti, Nano, and others. However, the car is expected to be more expensive than the advertised $2,500 Nano by TATA Motors. Volkswagen, the biggest car company in Europe, entered the pre-owned auto market in India. With the high gasoline prices, companies focusing on fuel efficiency and at the same time developing eco-friendly engines. Toyota has been very successful with its Prius hybrid. Honda is moving in the same direction and even luxury car maker BMW plans to introduce a hybrid vehicle later. TATA Motors is working on an electric car and experimenting with lithium ion batteries.

But India's long-term goal is to develop hydrogen-fueled automobiles. But at the outset, hybrid vehicles would have to be imported which could run into barriers. Still, Honda Siel Cars India has already introduced its very popular Civic model with hybrid propulsion. Government policy makers wonder what alternative courses should be pursued to minimize the environmental impact of the increasing number of cars. ■■

## 6. Selecting a Course

This is the point at which the plan is adopted—the real point of decision-making. Occasionally, an analysis and evaluation of alternative courses will disclose that two or more are advisable, and the manager may decide to follow several courses rather than the one best course.

## 7. Formulating Derivative Plans

When a decision is made, planning is seldom complete, and a seventh step is indicated. Derivative plans are almost invariably required to support the basic plan.

## 8. Quantifying Plans by Budgeting

After decisions are made and plans are set, the final step in giving them meaning, as was indicated in the discussion on types of plans, is to quantify them by converting them into budgets. The overall budget of an enterprise represents the sum total of income and expenses, with resultant profit or surplus, and the budgets of major balance sheet items such as cash and capital expenditures. Each department or

program of a business or some other enterprise can have its own budgets, usually of expenses and capital expenditures, which tie into the overall budget.

If done well, budgets become a means of adding the various plans and set important standards against which planning progress can be measured.

### Coordination of Short- and Long-Range Plans



Often short-range plans are made without reference to long-range plans. This is plainly a serious error. The importance of integrating the two types can hardly be overemphasized, and no short-run plan should be made unless it contributes to the achievement of the relevant long-range plan. Much waste arises from decisions about immediate situations that fail to consider their effect on more remote objectives.

Responsible managers should continually review and revise immediate decisions to determine whether they contribute to long-range programs, and subordinate managers should be regularly briefed on long-range plans so that they will make decisions consistent with the company's long-range goals. Doing this is far easier than to correct inconsistencies later, especially since short-term commitments tend to lead to further commitments along the same line.

## OBJECTIVES

An objective is **verifiable** when at the end of the period one can determine whether or not it has been achieved.

*Objectives* were defined earlier as the important ends toward which organizational and individual activities are directed. Since writers and practitioners make no clear distinction between the terms *goals* and *objectives*, they are used interchangeably in this book. Within the context of the discussion, it will become clear whether the objectives are long-term or short-term, broad or specific. The emphasis is on **verifiable** objectives, which means at the end of the period, it should be possible to determine whether or not the objective has been achieved. The goal of every manager is to create a surplus (in business organizations, this means profit). Clear and verifiable objectives facilitate measurement of the surplus as well as the effectiveness and efficiency of managerial actions.

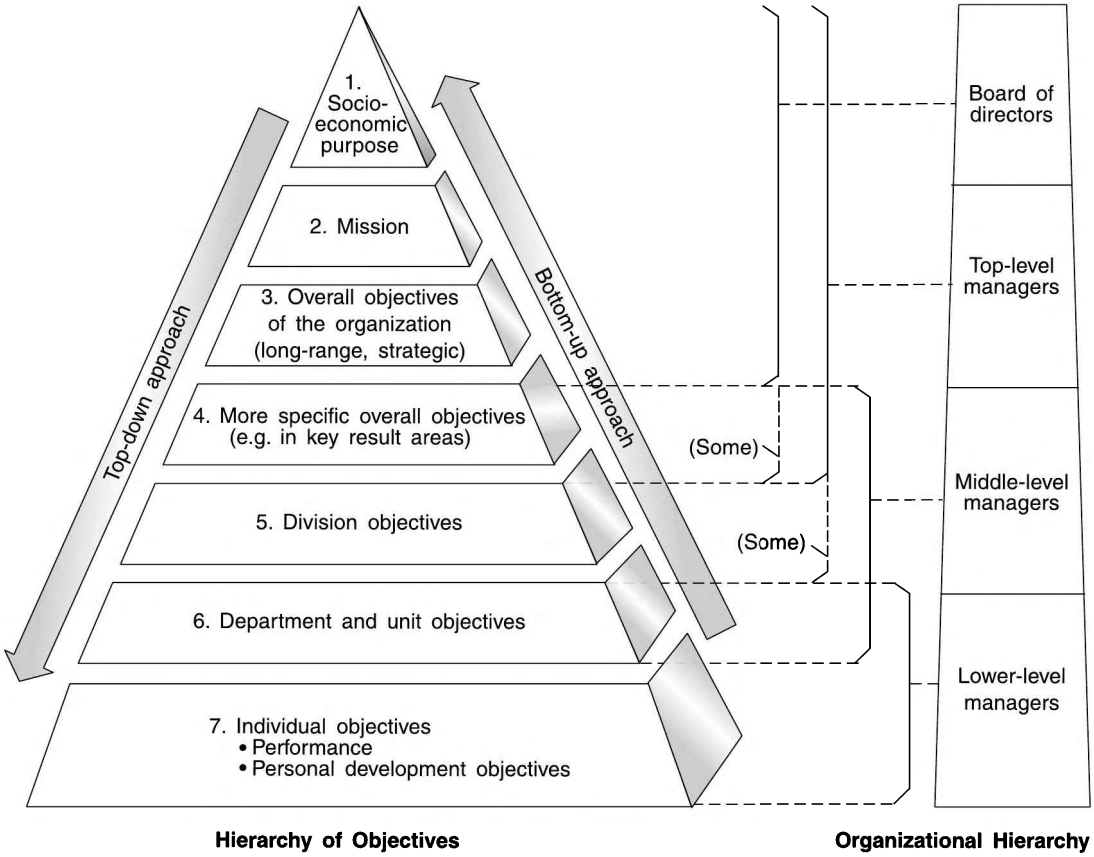
### The Nature of Objectives

Objectives state end results, and overall objectives need to be supported by subobjectives. Thus, objectives form a hierarchy as well as a network. Moreover, organizations and managers have multiple goals that are sometimes incompatible and may lead to conflicts within the organization, within the group, and even within individuals. A manager may have to choose between short-term and long-term performance, and personal interests may have to be subordinated to organizational objectives.

**Hierarchy of objectives** As Figure 4.3 shows, objectives form a hierarchy, ranging from the broad aim to specific individual objectives. The zenith of the hierarchy is the purpose or mission, which has two dimensions. First, there is the social purpose, such as contributing to the welfare of people by providing goods and services at a reasonable price. Second, there is the mission or purpose of the business,

**Figure 4.3**

**Relationship of Objectives and the Organizational Hierarchy.**
**Adapted from H. Weihrich and J. Mendleson, *Management: An MBO Approach* (Dubuque, Iowa: Wm. C. Brown Co., 1978), p. xi. Used with permission.**




which might be to furnish convenient, low-cost transportation for the average person. The stated mission might be to produce, market, and service automobiles. As you will notice, the distinction between purpose and mission is a fine one, and therefore, many writers and practitioners do not differentiate between the two terms. At any rate, these aims are in turn translated into general objectives and strategies, such as designing, producing, and marketing reliable, low-cost, fuel-efficient automobiles.

**Key result area** An area in which performance is essential for the success of the enterprise.

The next level of the hierarchy contains more specific objectives, such as those in the **key result areas**. These are the areas in which performance is essential for the success of the enterprise.

Although there is no complete agreement on what the key result areas of a business should be—and they may differ between enterprises—Peter F. Drucker suggests the following: market standing, innovation, productivity, physical and financial resources, profitability, manager performance and development, worker performance

and attitude, and public responsibility.[10] More recently, however, two other key result areas have become of strategic importance: service and quality.

Examples of objectives for key result areas are the following: to obtain a 10 percent return on investment by the end of calendar year 2005 (profitability); to increase the number of units of product X produced by 7 percent by June 30, 2005 without raising costs or reducing the current quality level (productivity).

The objectives have to be further translated into those of divisions, departments, and units down to the lowest level of the organization.



**Setting objectives and the organizational hierarchy[11]** As Figure 4.3 shows, managers at different levels in the organizational hierarchy are concerned with different kinds of objectives. The board of directors and top-level managers are very much involved in determining the purpose, the mission, and the overall objectives of the firm, as well as the more specific overall objectives in the key result areas. Middle-level managers, such as the vice president or manager of marketing or the production manager, are involved in the setting of key-result-area objectives, division objectives, and departmental objectives. The primary concern of lower-level managers is setting the objectives of departments and units as well as of their subordinates. Although individual objectives, consisting of performance and development goals, are shown at the bottom of the hierarchy, managers at higher levels also should set objectives for their own performance and development.

There are different views about whether an organization should use the top-down or the bottom-up approach in setting objectives, as indicated by the arrows in Figure 4.3. In the top-down approach, upper-level managers determine the objectives for subordinates, while in the bottom-up approach subordinates initiate the setting of objectives for their positions and present them to their superior.

Proponents of the top-down approach suggest that the total organization needs direction through corporate objectives provided by the chief executive officer (in conjunction with the board of directors). Proponents of the bottom-up approach, on the other hand, argue that top management needs to have information from lower levels in the form of objectives. In addition, subordinates are likely to be highly motivated by, and committed to, goals that they initiate. Personal experience has shown that the bottom-up approach is underutilized but that either approach alone is insufficient.

**Multiplicity of objectives** Objectives are normally multiple. For example, merely stating that a university's mission is education and research is not enough. It would be much more accurate (but still not verifiable) to list the overall objectives, which might be the following:

- Attracting students of high quality
- Offering basic training in the liberal arts and sciences as well as in certain professional fields
- Granting postgraduate degrees to qualified candidates
- Attracting highly regarded professors
- Discovering and organizing new knowledge through research
- Operating as a private school supported principally through tuition and gifts of alumni and friends

Likewise, at every level in the hierarchy of objectives, goals are likely to be multiple. Some people think that a manager cannot effectively pursue more than two to five objectives. The argument is that too many objectives tend to dilute the drive for their accomplishment. But the limit of two to five objectives seems too arbitrary; managers might pursue more significant objectives. It would be wise to state the relative importance of each objective so that major goals receive more attention than lesser ones. At any rate, the number of objectives managers should realistically set for themselves depends on how much they will do themselves and how much they can assign to subordinates, thereby limiting their role to one of assigning, supervising, and controlling.

## How to Set Objectives[12]

Without clear objectives, managing is haphazard. No individual and no group can expect to perform effectively and efficiently unless there is a clear aim. Table 4.1 illustrates some objectives and how they can be restated in a way that allows measurement.

**Table 4.1** Examples of Nonverifiable and Verifiable Objectives

| *Nonverifiable objective* | *Verifiable objective* |
|---|---|
| 1. To make a reasonable profit | 1. To achieve a return on investment of 12% at the end of the current fiscal year |
| 2. To improve communication | 2. To issue a two-page monthly newsletter beginning July 1, 2005, involving not more than 40 working hours of preparation time (after the first issue) |
| 3. To improve productivity of the production department | 3. To increase production output by 5% by December 31, 2005, without additional costs while maintaining the current quality level |
| 4. To develop better managers | 4. To design and conduct a 40-hour in-house program on the "fundamentals of management," to be completed by October 1, 2005, involving not more than 200 working hours of the management development staff and with at least 90% of the 100 managers passing the exam (specified) |
| 5. To install a computer system | 5. To install a computerized control system in the production department by December 31, 2005, requiring not more than 500 working hours of systems analysis and operating with not more than 10% downtime during the first three months or 2% thereafter |

**Quantitative and qualitative objectives** To be measurable, objectives must be verifiable. This means that one must be able to answer this question: At the end of the period, how do I know if the objective has been accomplished? For example, the objective of making a reasonable profit (see Table 4.1) does not state

how much profit is to be made, and what is reasonable to the subordinate may not be at all acceptable to the superior. In the case of such a disagreement, it is of course the subordinate who loses the argument. In contrast, a return on investment of 12 percent at the end of the current fiscal year can be measured; it answers these questions: how much? or what? or when?

At times, stating results in verifiable terms is more difficult. This is especially true when it involves the objectives for staff personnel and in government. For example, installing a computer system is an important task, but "to install a computer system" is not a verifiable goal. However, suppose the objective is "to install a computerized control system (with certain specifications) in the production department by December 31, 2005, with an expenditure of not more than 500 working hours." Then, goal accomplishment can be measured. Moreover, quality can also be specified in terms of computer downtime, such as "the system shall be operational 90 percent of the time during the first two months of operation."



LEADERSHIP PERSPECTIVE

## Public Goal Setting by Carlos Ghosn Was Risky, But it Worked at Nissan[13]

Setting goals and making them public can be risky. Yet, leaders have to set the direction for its followers. Carlos Ghosn who turned Nissan around set a very ambitious goal of selling 3.6 million cars in 2005. This verifiable goal was widely publicized. Doing so could have been risky for Ghosn because it can be measured and a non-achievement could have resulted in a loss of his leadership abilities. On the other hand, employees identified with this clear goal and were motivated to its achievement. Indeed, the goal was achieved, partly be introducing new models, the Murano and Fuga. Because of this leadership at Nissan, Ghosn has been considered heading an alliance between Japanese Nissan, French Renault, and American General Motors. ■■

**Guidelines for setting objectives** Setting objectives is indeed a difficult task. It requires intelligent coaching by the superior and extensive practice by the subordinate. The guidelines shown in Table 4.2 will help managers in setting their objectives.

The list of objectives should not be too long, yet it should cover the main features of the job. As this chapter has emphasized, objectives should be verifiable and should state what is to be accomplished and when. If possible, the quality desired and the projected cost of achieving the objectives should be indicated. Furthermore, objectives should present a challenge, indicate priorities, and promote personal and professional growth and development. These and other criteria for good objectives are summarized in Table 4.2. Testing objectives against the criteria shown in the checklist is a good exercise for managers and aspiring managers.

**Table 4.1** Checklist of Manager Objectives

If the objectives meet the criterion, write "+" in the box on the right of the statement. If they do not, mark "–" in the box.

| | |
|---|---|
| 1. Do the objectives cover the main features of my job? | ☐ |
| 2. Is the list of objectives too long? If so, can I combine some objectives? | ☐ |
| 3. Are the objectives verifiable, that is, will I know at the end of the period whether they have been achieved? | ☐ |
| 4. Do the objectives indicate: | |
| (a) quantity (how much)? | ☐ |
| (b) quality (how well, or specific characteristics)? | ☐ |
| (c) time (when)? | ☐ |
| (d) cost (at what cost)? | ☐ |
| 5. Are the objectives challenging yet reasonable? | ☐ |
| 6. Are priorities assigned to the objectives (ranking, weight, etc.)? | ☐ |
| 7. Does the set of objectives also include: | |
| (a) improvement objectives? | ☐ |
| (b) personal development objectives? | ☐ |
| 8. Are the objectives coordinated with those of other managers and organizational units? | ☐ |
| Are they consistent with the objectives of my superior, my department, and the company? | ☐ |
| 9. Have I communicated the objectives to all who need to be informed? | ☐ |
| 10. Are the short-term objectives consistent with the long-term aims? | ☐ |
| 11. Are the assumptions underlying the objectives clearly identified? | ☐ |
| 12. Are the objectives expressed clearly, and are they in writing? | ☐ |
| 13. Do the objectives provide for timely feedback so that I can take any necessary corrective steps? | ☐ |
| 14. Are my resources and authority sufficient for achieving the objectives? | ☐ |
| 15. Have I given the individuals who are expected to accomplish the objectives a chance to suggest their objectives? | ☐ |
| 16. Do my subordinates have control over aspects for which they are assigned responsibility? | ☐ |

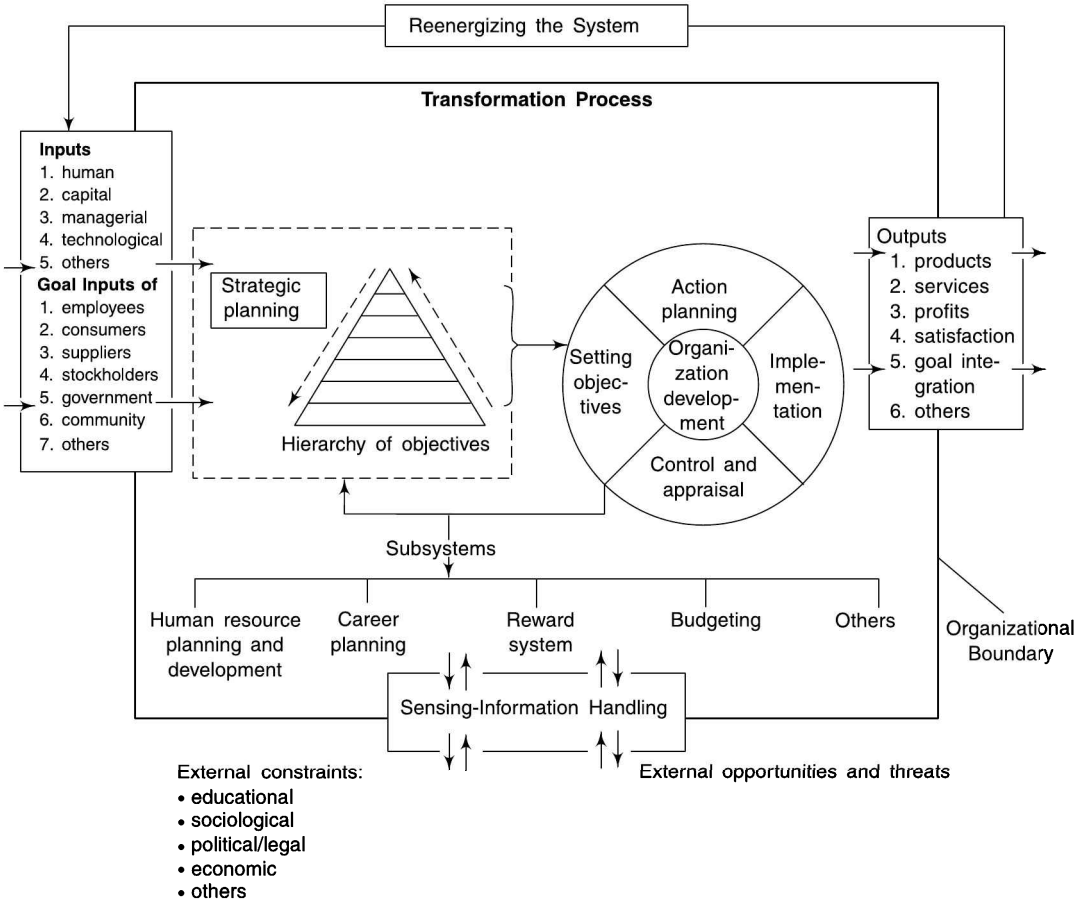
**Management by objectives** A comprehensive managerial system that integrates many key managerial activities in a systematic manner and is consciously directed toward the effective and efficient achievement of organizational and individual objectives.

## EVOLVING CONCEPTS IN MANAGEMENT BY OBJECTIVES[14]

Management by objectives (MBO) is now practiced around the world. Yet, despite its wide application, it is not always clear what is meant by MBO. Some still think of it as an appraisal tool; others see it as a motivational technique; still others consider MBO a planning and control device. In other words, definitions and applications of MBO differ widely. We define **management by objectives** as a comprehensive managerial system that integrates many key managerial activities in a systematic manner and is consciously directed toward the effective and efficient achievement of organizational and individual objectives. This view of MBO as a system of managing is not shared by all. While some still define MBO in a very narrow, limited way, we prefer to see it as a comprehensive goal-driven, success-oriented management system as shown in Figure 4.4. Besides being used for performance appraisal, as an

**Figure 4.3**

**Systems Approach to Management by Objectives.**
**Adapted from Heinz Weihrich, *Management Excellence—Productivity through MBO* (New York: McGraw-Hill, 1985) p. 18.**




instrument for motivating individuals, and in strategic planning, there are still other managerial subsystems that can be integrated into the MBO process. They include human resource planning and development (staffing as well as individual and organization development), career planning (building on personal strengths and overcoming weaknesses), the reward system (paying for performance), budgeting (planning and controlling), and other managerial activities important for a specific position. These various managerial activities need to be integrated into a system. In short, MBO, to be effective, must be considered a way of managing as shown in Figure 4.4 and not an addition to the managerial job.[15]

## Benefits and Weaknesses of Management by Objectives

Although goal-oriented management is now one of the most widely practiced managerial approaches, its effectiveness is sometimes questioned. Faulty implementation is often blamed, but another reason is that MBO may be applied as a mechanistic technique focusing on selected aspects of the managerial process without integrating them into a system.

**Benefits of management by objectives** There is considerable evidence, much of it from laboratory studies, that shows the motivational aspects of clear goals. But there are other benefits, such as the following:

- Improvement of managing through results-oriented planning
- Clarification of organizational roles and structures as well as delegation of authority according to the results expected of the people occupying the roles
- Encouragement of commitment to personal and organizational goals
- Development of effective controls that measure results and lead to corrective actions

**Failures of management by objectives and some recommendations** Despite all its advantages, an MBO system has a number of weaknesses. Most are due to shortcomings in applying the MBO concepts. Failure to teach the philosophy of MBO is one of the weaknesses of certain programs. Managers must explain to subordinates what it is, how it works, why it is being done, what part it will play in appraising performance, and, above all, how participants can benefit. The philosophy is built on the concepts of self-control and self-direction.

Failure to give guidelines to goal setters is often another problem. Managers must know what the corporate goals are and how their own activities fit in with them. Managers also need planning premises and knowledge of major company policies.

There is also the difficulty of setting verifiable goals with the right degree of flexibility. Participants in MBO programs report at times that the excessive concern with economic results puts pressure on individuals that may encourage questionable behavior. To reduce the probability of resorting to unethical means to achieve results, top management must agree to reasonable objectives, clearly state behavioral expectations, and give high priority to ethical behavior, rewarding it as well as punishing unethical activities.

In addition, emphasis on short-run goals can be done at the expense of the longer-range health of the organization. Moreover, the danger of inflexibility can make managers hesitate to change objectives, even if a changed environment would require such adjustments.

Other dangers include the overuse of quantitative goals and the attempt to use numbers in areas where they are not applicable, or they may downgrade important goals that are difficult to state in terms of end results. For example, a favorable company image may be the key strength of an enterprise, yet stating this in quantitative terms is difficult. There is also the danger of forgetting that managing involves more than goal setting.

But, even with the difficulties and dangers of managing by objectives in certain situations, this system emphasizes in practice the setting of goals long known to be an essential part of planning and managing.

## SUMMARY

Planning involves selecting the missions and objectives as well as the actions to achieve them. It requires decision-making, which means choosing a future course of action from among alternatives. Planning and controlling are closely interrelated, although they are discussed separately in this book. There are many types of plans, such as missions or purposes, objectives or goals, strategies, policies, procedures, rules, programs, and budgets. Once an opportunity is recognized, a manager plans rationally by establishing objectives, making assumptions (premises) about the present and future environment, finding and evaluating alternative courses of action, and choosing a course to follow. Next, the manager must make supporting plans and devise a budget. These activities must be carried out with attention to the total environment. Short-range plans must of course be coordinated with long-range plans.

Objectives are the end points toward which activities are aimed. Objectives are verifiable if it is possible, at the end of the period, to determine whether they have been accomplished. Objectives form a hierarchy, starting from corporate missions or purposes going down to individual goals. Managers can best determine the number of objectives they should realistically set for themselves by analyzing the nature of the job and how much they can do themselves and how much they can delegate. In any case, managers should know the relative importance of each of their goals.

Management by Objectives (MBO) has been widely used for performance appraisal and employee motivation, but it is really a system of managing. Among its benefits, MBO results in better managing, often forces managers to clarify the structure of their organizations, encourages people to commit themselves to their goals, and helps develop effective controls.

Some of its weaknesses are that managers sometimes fail to explain the philosophy of MBO (which emphasizes self-control and self-direction) to subordinates or give them guidelines for their goal setting. In addition, goals themselves are difficult to set, tend to be short-term, and may become inflexible despite changes in the environment. People, in their search for verifiability, may overemphasize quantifiable goals.



## KEY IDEAS AND CONCEPTS FOR REVIEW

- ✔ Planning
- ✔ Mission or purpose
- ✔ Objective or goal
- ✔ Strategy
- ✔ Policy
- ✔ Procedure
- ✔ Rule
- ✔ Program
- ✔ Budget
- ✔ Planning steps
- ✔ Hierarchy of objectives
- ✔ Key result areas
- ✔ Quantitative and qualitative objectives
- ✔ Verifiability

- ✔ Evolving concepts in Management by Objectives (MBO)
- ✔ Systems approach to MBO
- ✔ Benefits of MBO
- ✔ Weaknesses of MBO
- ✔ Recommendations for improving MBO

## FOR DISCUSSION

1. "Planning is looking ahead, and control is looking back." Comment.
2. Draw up a statement of policy and devise a brief procedure that might be useful in implementing it. Are you sure your policy is not a rule?
3. Take an organization that you know and identify its purpose or mission, even if it is not formally stated by the enterprise.
4. To what extent do you believe that managers you have known in business or elsewhere have a clear understanding of their objectives? If you think they do not, how would you suggest that they go about setting their objectives?
5. Some people object to defining long-term goals because they think that knowing what will happen over a long period is impossible. Do you believe this is an intelligent position to take? Why or why not?
6. Do you think that managing by objectives could be introduced in a government agency? A university? A college fraternity or sorority?
7. What are your five most important personal objectives? Are they long- or short-range? Are the objectives verifiable?
8. In your organization, what does your superior expect from you in terms of performance? Is it stated in writing? If you wrote down your job objective and your boss wrote down what he or she expects of you, would the two be consistent?

## EXERCISE/ACTION STEPS

In this chapter, the overall objectives of a university were identified. Develop overall objectives for your university, for your college, and for the various departments in your college. Show how these objectives are interrelated to form a network.

## INTERNET RESEARCH

1. Use a search engine to look for "management by objectives" and identify how MBO is used as a planning tool? For managerial appraisal? For motivating people? In conjunction with strategic planning? For developing managers?
2. Search the Internet for the term "budget" and discuss your findings with the class.

## International Case Developing Verifiable Goals

The division manager had recently heard a lecture on Management by Objectives. His enthusiasm, kindled at that time, grew the more he thought about it. He finally decided to introduce the concept and see what headway he could make at his next staff meeting.

He recounted the theoretical developments in this technique, cited the advantages to the division of its application, and asked his subordinates to think about adopting it.

It was not as easy as everyone had thought. At the next meeting, several questions were raised. "Do you have division goals assigned by the president to you for next year?" the finance manager wanted to know.

"No, I do not," the division manager replied. "I have been waiting for the president's office to tell me what is expected, but they act as if they will do nothing about the matter."

"What is the division to do then?" the manager of production asked, rather hoping that no action would be indicated.

"I intend to list my expectations for the division," the division manager said. "There is not much mystery about them. I expect $30 million in sales; a profit on sales before taxes of 8 percent; a return on investment of 15 percent; an ongoing program in effect by June 30, with specific characteristics I will list later, to develop our own future managers; the completion of development work on our XZ model by the end of the year; and stabilization of employee turnover at 5 percent."

The staff was stunned that their superior had thought carefully about these verifiable objectives and stated them with such clarity and assurance. They were also surprised about his sincerity in wanting to achieve them.

"During the next month, I want each of you to translate these objectives into verifiable goals for your own functions. Naturally, they will be different for finance, marketing, production, engineering, and administration. However you state them, I will expect them to add up to the realization of the division goals."

**Questions**

1. Can a division manager develop verifiable goals, or objectives, when they have not been assigned to him or her by the president? How? What kind of information or help do you believe is important for the division manager to have from headquarters?
2. Did the division manager set the goals in the best way? What would you have done?

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# 5 Strategies, Policies, and Planning Premises

PART 2

## CHAPTER OBJECTIVES

After studying this chapter, you should be able to:

- Explain the nature and purpose of strategies and policies
- Describe the strategic planning process
- Understand the TOWS Matrix and the business portfolio matrix
- Describe some major kinds of strategies and policies and the hierarchy of strategies
- Identify Porter's generic strategies
- Discuss the nature of premises and forecasts

Today, most business enterprises engage in strategic planning, although the degree of sophistication and formality varies considerably. Conceptually, strategic planning is deceptively simple: analyze the current and expected future situation, determine the direction of the firm, and develop means for achieving the mission. In reality, this is an extremely complex process that demands a systematic approach for identifying and analyzing factors external to the organization and matching them with the firm's capabilities.

Planning is done in an environment of uncertainty. No one can be sure if the external as well as the internal environment will be the same even next week, much less several years from now. Therefore, people make assumptions or forecasts about the anticipated environment. Some of the forecasts become assumptions for other plans. For example, the gross national product forecast becomes the assumption for sales planning, which in turn becomes the basis for production planning, and so on.

In this chapter, you will learn about the nature and purpose of strategies and policies, the strategic planning process (which identifies the critical aspects of formulating a strategy), the TOWS Matrix (a tool for systematically integrating external and internal factors), the business portfolio matrix (a tool for allocating resources), some major kinds of strategies and policies, the hierarchy of strategies, and generic strategies. Because plans are made in an environment of uncertainty, you will also learn about premising and forecasting.

## THE NATURE AND PURPOSE OF STRATEGIES AND POLICIES

Strategies and policies are closely related. Both give direction, both are the framework for plans, and both are the basis of operational plans, and both affect all areas of managing.

**Strategy** The determination of the mission or purpose and the basic long-term objectives of an enterprise, followed by the adoption of courses of action and allocation of resources necessary to achieve these aims.

The term *strategy* (which is derived from the Greek word *strategos*, meaning "general") has been used in different ways. Authors differ in at least one major aspect. Some writers focus on both the end points (mission/purpose and goals/objectives) and the means of achieving them (policies and plans). Others emphasize the means to the ends in the strategic process rather than the ends per se. As pointed out in Chapter 4, **strategy** refers to the determination of the mission (or the fundamental purpose) and the basic long-term objectives of an enterprise, followed by the adoption of courses of action and allocation of resources necessary to achieve these aims. Therefore, objectives are part of strategy formulation.

**Policies** General statements or understandings that guide managers' thinking in decision-making.

**Policies** are general statements or understandings that guide managers' thinking in decision-making. They ensure that decisions fall within certain boundaries. They usually do not require action but are intended to guide managers in their commitment to the decision they ultimately make.

The essence of policy is discretion. Strategy, on the other hand, concerns the direction in which human and material resources will be applied in order to increase the chance of achieving selected objectives.

**LEADERSHIP PERSPECTIVE**

### Lee Kun-Hee Leads the Value- and Policy-driven Samsung Company for Global Recognition[1]

The Samsung Group is a large Korean conglomerate that focuses on electronics and financial services. In the past, many Korean companies encountered difficulties because they diversified into unrelated fields. In its new approach to management, Samsung tries to avoid the pitfalls of other companies. At the turn of the century, Samsung initiated a policy designed to make the company a leader in its field, competing against firms such as Sony of Japan.

The company is driven by its values and its philosophy, which states: "We will devote our people and technologies to create superior products and services, thereby contributing to a better global society."[2] Samsung realizes the importance of its people and the use of the latest technologies for achieving success in the marketplace. At the same time, it is aware of the responsibility to contribute to society, not only in Korea but also worldwide.

Chairman Lee Kun-Hee laid the groundwork for a new approach to management that considers defects as a crime. Quality, superior products, and excellent customer service are considered key factors for success in the very competitive environment that has been dominated by Japanese firms. With its "digital management"

approach, Samsung attempts to exploit the opportunities created by the information age technologies.

Samsung's values, philosophies, and policies, as well as its goal of becoming a global leader in its field, have attracted many Korean university students. Will these young people help the company to successfully compete in the global environment?

■■



To be effective, strategies and policies must be put into practice by means of plans, with increasing details until they get down to the nuts and bolts of operation. The action plans through which strategies are executed are known as *tactics*. Strategies must be supported by effective tactics.

## THE STRATEGIC PLANNING PROCESS

Although specific steps in the formulation of a strategy may vary, the process can be built, at least conceptually, around the key elements shown in Figure 5.1 and elaborated in the following.

### Inputs to the Organization

The various organizational inputs, including the goal inputs of the claimants, were discussed in Chapter 1 and need no elaboration.

### Industry Analysis

As will be pointed out later in this chapter, Michael Porter suggests that the formulation of a strategy requires the evaluation of the attractiveness of an industry by analyzing the external environment. The focus should be on the kind of competition within an industry, the possibility of new firms entering the market, the availability of substitute products or services, and the bargaining positions of the suppliers as well as the buyers or customers.

### Enterprise Profile

The enterprise profile is usually the starting point for determining where the company is and where it should go. Thus, top managers determine the enterprise's mission and clarify its geographic orientation, such as whether it should operate in selected regions, throughout the home country, or even in different countries. In addition, managers assess the competitive position of their firm.

### Orientation, Values, and Vision of Executives[3]

The enterprise profile is shaped by people, especially executives; and their orientation and values are important for formulating the strategy. They set the organizational climate, and they determine the direction of the firm through their vision that

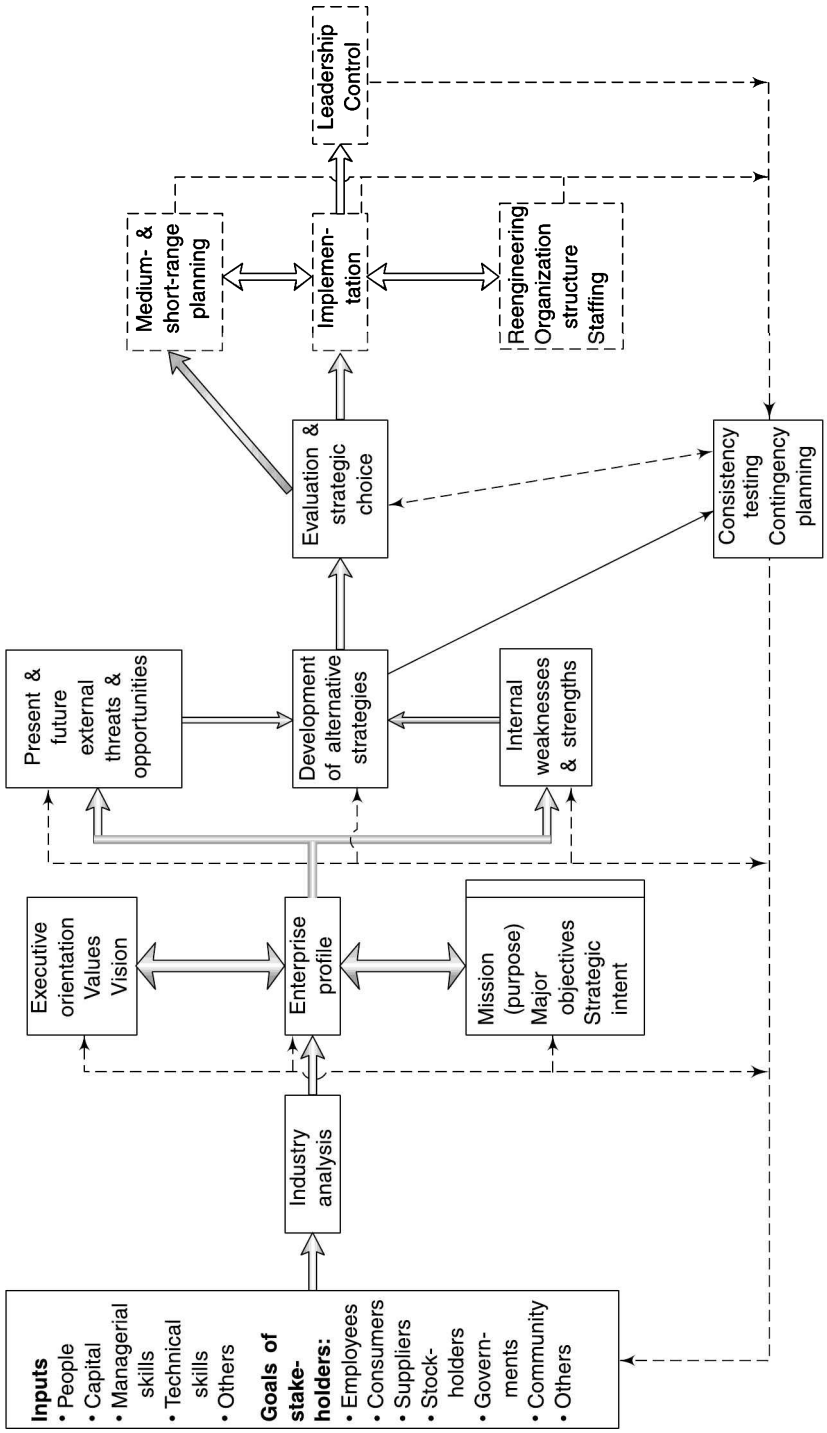


**Figure 5.1**

**Strategic Planning Process Model.**

**Adapted and modified from Heinz Weihrich, "The TOWS Matrix: A Tool for Situational Analysis," *Long Range* Planning, vol. 15, no. 2 (1982), pp. 54–66.**

answers the question "What do we want to become?"[4] Consequently, their values, their preferences, and their attitudes toward risks have to be carefully examined because they have an impact on the strategy. For example, even if the alternative of distributing spirits may appear profitable, executives may decide against such a strategy because of top management's value system that condemns alcoholic beverages.

## Mission (Purpose), Major Objectives, and Strategic Intent[5]



**Mission** A statement that answers the question "What is our business?"

**Strategic intent** The commitment to win in the competitive environment.

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www.xerox.com

www.honda.com

www.ford.com

The *mission*, also sometimes called the purpose, is the answer to the question "What is our business?" The major *objectives* are the end points toward which the activities of the enterprise are directed. These topics were discussed in the previous chapter.

**Strategic intent** is the commitment to win in the competitive environment. Professors Gary Hamel and C. K. Prahalad analyzed companies that had achieved global leadership.[6] They found that those firms had an obsession with winning, not only at the top level but also throughout the organization. This obsession is called strategic intent and is illustrated by Komatsu's intent to "encircle Caterpillar," its main rival, or Canon's idea to "beat Xerox," or Honda's intent to become an automotive pioneer, "a second Ford." The authors point out that strategic intent requires personal effort and commitment. The intent statement is stable over time and focuses on the essence of winning.

## Present and Future External Environment

The present and future external environment must be assessed in terms of threats and opportunities. The evaluation focuses on the competitive situation as well as on economic, social, political, legal, demographic, and geographic factors. In addition, the environment is scanned for technological developments, for products and services in the market, and for other pertinent factors in determining the competitive situation of the enterprise.

## Internal Environment[7]

Similarly, the firm's internal environment should be audited and evaluated with respect to its resources and its weaknesses and strengths in research and development, production, operation, procurement, marketing, products, and services. Other internal factors that are important for formulating a strategy should be assessed, including human and financial resources, as well as the company image, organization structure and climate, planning and control system, and relations with customers.

## Development of Alternative Strategies

www.hyundai.com

www.gm.com

Strategic alternatives are developed on the basis of an analysis of the external and internal environments. An organization may pursue many different kinds of strategies.[8] It may *specialize* or *concentrate*, as the Korean Hyundai did by producing lower-priced cars (in contrast to General Motors, for example, which has a complete product line ranging from inexpensive to luxury cars). Under the leadership of its

chief executive, Chung Mong Koo, the company introduced the competitively priced sport utility vehicle Santa Fe, which was well received by the market.[9]

www.kmart.com
www.borders-groupinc.com (Walden)
www.payless-drug.com
www.toyota.com
www.nummi.com

Alternatively, a firm may *diversify*, extending the operation into new and profitable markets. Kmart Corporation formed a Specialty Retailing Group that included stores such as Walden Book Company, Builders Square, Designer Depot, and PayLess Drug Stores. Still another strategy is *international expansion* to other countries, as described in Chapter 3. Other examples of possible strategies are *joint ventures* and *strategic alliances*, which may be appropriate for some firms.[10] They are especially suitable for big undertakings in which firms have to pool their resources, as illustrated by the joint venture of General Motors and Toyota to produce small cars in California.[11]

Under certain circumstances, a company may have to adopt a *liquidation* strategy by terminating an unprofitable product line or even dissolving the firm, as illustrated by the Savings and Loan Associations, or declare bankruptcy, as exemplified by the energy company Enron. But in some cases, liquidation may not be necessary, but a *retrenchment* strategy may be sufficient. In such a situation, the company may curtail its operation temporarily.

These are just a few examples of possible strategies. In practice, companies, especially large ones, pursue a combination of strategies.

## Evaluation and Choice of Strategies[12]

The various strategies have to be carefully evaluated before the choice is made. Strategic choices must be considered in light of the risks involved in a particular decision. Some profitable opportunities may not be pursued because failure in a risky venture could result in bankruptcy of the firm. Another critical element in choosing a strategy is timing. Even the best product may fail if it is introduced to the market at an inappropriate time. Moreover, the reaction of competitors must be taken into consideration. When IBM reduced the price of its personal computer in reaction to the success of Apple's Macintosh computer, firms producing IBM-compatible computers had little choice but to reduce their prices as well. This illustrates the interconnection of the strategies of firms in the same industry.

## Consistency Testing and Contingency Planning

The last key aspect of the strategic planning process is testing for consistency and preparing for contingencies. During all phases of the strategic planning process, consistency testing is essential. Since the future cannot be predicted with a high degree of certainty, contingency plans need to be prepared. For example, a strategy may be prepared with the assumption that the gross national product may increase 3 percent annually over the next three years. A contingency plan may also be made in which the scenario includes a major recession.

### Medium- and Short-Range Planning, Implementation through Organizing, Staffing, Leading, and Controlling

Although not a part of the strategic planning process (and therefore shown by broken lines in Figure 5.1), medium- and short-range planning as well as implementation of the plans must be considered during all phases of the process. Implementation of the strategy requires organizing, perhaps even reengineering the organization (Part 3 in this book), staffing, that is filling and keeping filled the positions in the organization structure (Part 4) and providing leadership through motivation and effective communication (Part 5). Controls must also be installed for monitoring performance against plans Part 6). The importance of feedback is shown by the loops in the model. These aspects of strategy implementation are discussed later in the book.



## THE TOWS MATRIX: A MODERN TOOL FOR ANALYSIS OF THE SITUATION

Today, strategy designers are aided by a number of matrices that show the relationships of critical variables, such as the Boston Consulting Group's business portfolio matrix, which will be discussed later. For many years, the SWOT analysis has been used to identify a company's strengths, weaknesses, opportunities, and threats. However, this kind of analysis is static and seldom leads to the development of distinct alternative strategies based on it. Therefore, the TOWS Matrix has been introduced for analyzing the competitive situation of the company or even of a nation that leads to the development of four distinct sets of strategic alternatives.[13]

The TOWS Matrix has a wider scope and a different emphasis from the business portfolio matrix. The former does not replace the latter. The TOWS Matrix is a conceptual framework for a systematic analysis that facilitates matching of the external threats and opportunities with the internal weaknesses and strengths of the organization.

It is common to suggest that companies should identify their strengths and weaknesses, as well as the opportunities and threats in the external environment, but what is often overlooked is that combining these factors may require distinct strategic choices. To systematize these choices, the TOWS Matrix has been proposed, where *T* stands for threats, *O* for opportunities, *W* for weaknesses, and *S* for strengths. The TOWS model starts with the threats (*T* in TOWS) because in many situations, a company undertakes strategic planning as a result of a perceived crisis, problem, or threat.

### Four Alternative Strategies

Figure 5.2 present the four alternative strategies of the TOWS Matrix.* The strategies are based on the analysis of the external environment (threats and opportunities) and the internal environment (weaknesses and strengths):

*Although the emphasis is on strategies in this discussion, similar analyses can be made for developing more detailed tactics or action plans.

**Figure 5.2**

**TOWS Matrix for Strategy Formulation.**

| Internal factors / External factors | **Internal strengths (S)** e.g., strengths in management, operations, finance, marketing, R&D, engineering | **Internal weaknesses (W)** e.g., weaknesses in areas shown in the box of "strengths" |
|---|---|---|
| **External opportunities (O):** (Consider risks also) e.g., current and future economic conditions, political and social changes, new products, services, and technology | **SO strategy: Maxi-Maxi** Potentially the most successful strategy, utilizing the organization's strengths to take advantage of opportunities | **WO strategy: Mini-Maxi** e.g., developmental strategy to overcome weaknesses in order to take advantage of opportunities |
| **External threats (T):** e.g., lack of energy, competition, and areas similar to those shown in the "opportunities" box above | **ST strategy: Maxi-Mini** e.g., use of strengths to cope with threats or to avoid threats | **WT strategy: Mini-Mini** e.g., retrenchment, liquidation, or joint venture to minimize both weaknesses and threats |

1. The *WT strategy* aims to minimize both weaknesses and threats and may be called the Mini–Mini (for "minimize–minimize") strategy. It may require that the company, for example, form a joint venture, retrench, or even liquidate.
2. The *WO strategy* attempts to minimize the weaknesses and maximize the opportunities. Thus, a firm with weaknesses in some areas may either develop those areas within the enterprise or acquire the needed competencies (such as technology or persons with needed skills) from outside in order to enable it to take advantage of opportunities in the external environment.
3. The *ST strategy* is based on using the organization's strengths to deal with threats in the environment. The aim is to maximize the former while minimizing the latter. Thus, a company may use its technological, financial, managerial, or marketing strengths to cope with the threats of a new product introduced by its competitor.
4. The *SO strategy*, which capitalizes on a company's strengths to take advantage of opportunities, is the most desirable. Indeed, it is the aim of enterprises to move from other positions in the matrix to this one. If they have weaknesses, they will strive to overcome them, making them strengths. If they face threats, they will cope with them so that they can focus on opportunities.

INTERNATIONAL PERSPECTIVE

### Where Did All the Saturns Go?[14]

Some 19 years before its demise, Saturn was introduced as a "Different kind of a car company." Yet, it was dropped from the GM car line in 2009. Saturn was introduced as a stand-alone company with its own factory and dealerships. The original car had a fixed price and sold for less than $11,000. Things began to change when GM's CEO Roger B. Smith retired. Then a larger model, the L-Series was introduced and flopped.

In 2007, Saturn introduced the Lexus-style Aura family line for some $29,000. But the Saturn brand did not attract customers. Therefore, the Saturn brand that began as a new kind of car company has been dropped from GM's line up. Changing a brand image may be detrimental to the product. ■■



## Time Dimension and the TOWS Matrix

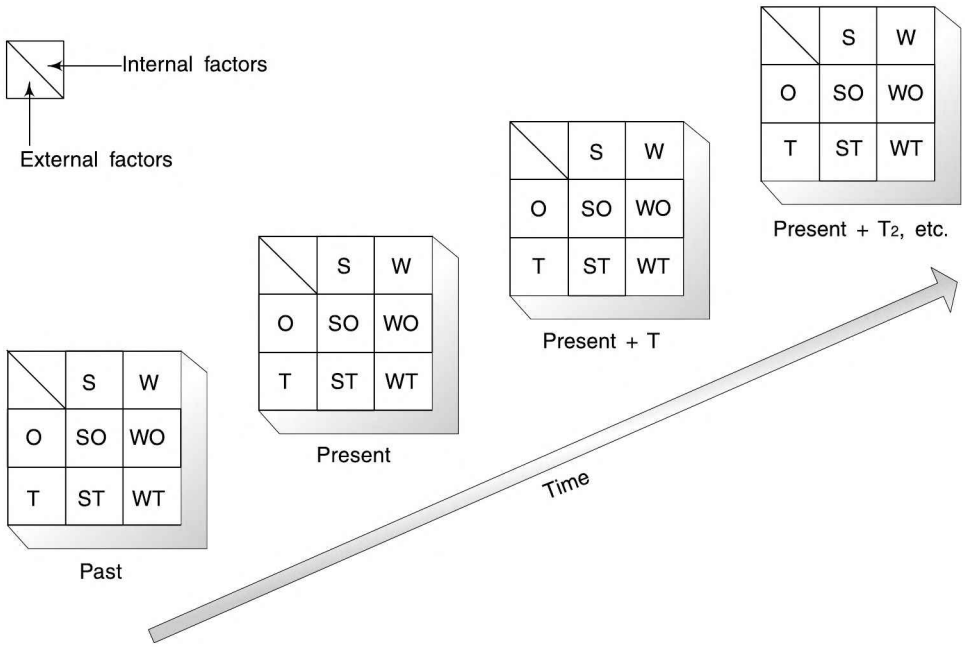
So far, the factors displayed in the TOWS Matrix pertain to analysis at a particular point in time. However, external and internal environments are dynamic: some factors change over time, while others change very little. Hence, strategy designers must prepare several matrices at different points in time, as shown in Figure 5.3. Thus, one may start with a TOWS analysis of the past, continue with an analysis of the present, and, perhaps most important, focus on different time periods (T1, T2, etc.) in the future.

## Application of the TOWS Merger Matrix for Mergers, Acquisitions, Joint Ventures, and Alliances

Companies around the world now use the TOWS Matrix; the matrix has also been included in several modern textbooks on strategic management.[15] Recently, the TOWS Matrix concept has been introduced for planning mergers, acquisitions, joint ventures, and alliances.[16] Whenever two partners consider joint activities, it is prudent to analyze the strengths and weaknesses for each partner as well as their opportunities and threats. Moreover, their alternative strategies *before* their association should be considered: these two TOWS Matrices provide a better understanding of the prospective partners before the actual linkage. For example, complementary strengths and weaknesses could result in a competitive advantage for both companies. On the other hand, repetition and overlap may result in duplication of efforts. After the two matrices are evaluated, a third matrix should be developed for the partnership. This is especially important for acquisitions and mergers because of the relative permanency of the resulting entity. Preparing the three TOWS Matrices can also allow potential problems to be identified in more loosely coupled partnerships such as a strategic alliance. The TOWS Merger Matrix will be illustrated by the Daimler–Chrysler merger in the closing section of Part 2.

**Figure 5.2**

**Dynamics of the TOWS Matrix.**




## BLUE OCEAN STRATEGY: IN PURSUIT OF OPPORTUNITIES IN UNCONTESTED MARKETS[17]

In the TOWS Matrix discussion it was shown that companies could use their strengths and overcome their weaknesses by taking advantage of opportunities and coping with threats. It was suggested that the potentially most successful strategy is to use the enterprise's strengths and to take advantage of opportunities.

In the recently published book *Blue Ocean Strategy – How to Create Uncontested Market Space and Make the Competition Irrelevant* the authors W. Chan Kim and Renee Mauborgne specifically suggest to focus on opportunities that explore uncontested waters (opportunities) in the "blue ocean" rather than trying to beat the competition in the existing industry, or the "red ocean" as the authors suggest. The red ocean may be illustrated by the "bloody" current competition in the automobile industry in which companies try to be a little better than their competitor by, for example, having a lower cost structure. In contrast, the blue ocean strategy may be illustrated by eBay's online auction by entering a market without competitors. Let us explore further the differences between the red and blue ocean strategies.

Traditional competitive strategies, operating in the red ocean, aimed at beating the competition in an existing market. Companies tried to be better than their competitors. Michael Porter at Harvard suggested that companies have to make a strategic choice between differentiation by offering the customers something special

for which they are willing to pay a premium price, or having a lower cost structure as exemplified by Wal-Mart as discussed later in this chapter.

The blue ocean strategy, by contrast, focuses on the uncontested market by offering a product or service that is unique in a market space where there is no competitor, thus making competition irrelevant as the subtitle of the book Blue Ocean Strategy suggests. Rather than competing in an existing demand situation, the blue ocean strategy attempts to create and develop new demand for its products or services. Moreover, a successful company will pursue strategies that focus on differentiation and low cost as was illustrated by the introduction of the Lexus car that had differentiation features of luxury cars but at a lower price. This way, Toyota, the maker of Lexus, created value for the buyer. *Value innovation* is more than simple innovation. It is a strategy that requires that the total company is committed to the creation of value for the customer by offering something special with relatively low cost and price.



To capture the blue ocean and to make the competition irrelevant, Kim and Mauborgne introduced a diagnostic tool and framework for action called *The Strategic Canvas*. This tool identifies the important relevant factors in an industry in which companies compete. These factors vary from industry to industry. In the airline industry the factors may, for example, include the price of the airfare, the meals, the friendliness of the service, and so on. Southwest Airline, a successful airline in America, rates low in price, meals, and connections at airport hubs but rates higher in service friendliness and frequency of flights than other airlines. Since Southwest had little competition on those latter criteria where it had high ratings, it pursued a blue ocean strategy.

For companies aiming for a blue ocean strategy, four actions should be considered. First, identify and eliminate those factors that may be unimportant to the buyer. Second, if elimination is not an option, consider reducing those factors. Third, raise or strengthen those factors that are unique. And fourth, create new or unique factors that are wanted by the buyers but are ignored by the competitors. This was what Southwest Airlines and other enterprises did in charting a blue ocean strategy.

How can the blue ocean strategy be applied in formulating a strategy based on the TOWS Matrix as shown in Figure 5.2? The traditional red ocean strategy can be exemplified by the ST (strengths-threats) strategy whereby a company uses its strengths to cope with the threats created by the competition. Head-on competition often results in a blood bath through a red ocean strategy. In contrast, The SO (strengths-opportunities) strategy in which a company uses its strengths to take advantage of opportunities is an illustration of a blue ocean strategy. It is true that in the TOWS Matrix analysis, opportunities in general were considered while Kim and Mauborgne focused on unique opportunities that have been neglected by competitors.

There is another blue ocean strategy alternative, namely the WO strategy in which a company realizes its weakness and recognize that one way to overcome the weakness is to search for unique opportunities to overcome it. Often a company with weaknesses may be in distress and then may be motivated to search intensely for opportunities that have not been exploited by its competitors, that is adopting a blue ocean strategy.

In summary, companies adopting a blue ocean strategy may pursue both the SO as well as the WO alternative strategies shown in Figure 5.2. While it may be unavoidable to engage in the ST strategy, enterprises may be wise to first attempt to chart a blue ocean strategy to avoid the bloody confrontation resulting from the ST alternative.

**INTERNATIONAL PERSPECTIVE**

### Zipcar[18]

One example of a company with a blue ocean strategy is Zipcar, a car-sharing company founded in Cambridge, Massachusetts. The company with a new concept in the United States focuses on an uncontested market by using wireless technology at strategically placed bases in cities. The company uses a simple reservation system through which customers can view the availability of the car which can then be reserved online. A wireless link records the time and usage. Zipcar faces some competition from "CarShare" in the United States; the big rental companies such as Hertz and Enterprise, "WeCar" in St. Louis and "I-GO" in Chicago are also beginning to use a similar car-sharing concept. Firms in other countries do likewise. Therefore, to some extent the market is contested. The untapped market for Zipcar would be the use of the sharing concept with partnering with other firms by offering, for example, boat sharing or car sharing in cities that do not have such services. ■■

## THE PORTFOLIO MATRIX: A TOOL FOR ALLOCATING RESOURCES

www.bcg.com

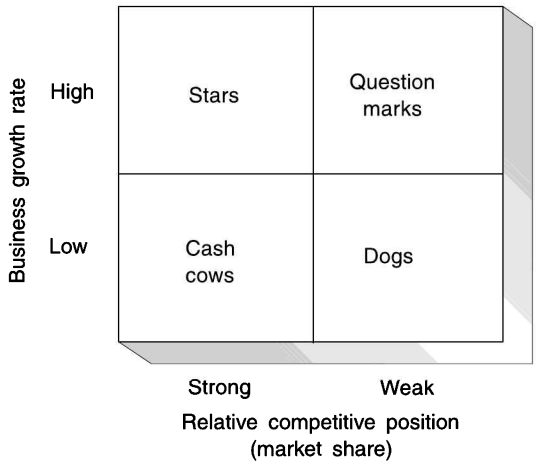
The Boston Consulting Group developed the Business Portfolio Matrix.[19] Figure 5.4, a simplified version of the matrix, shows the linkages between the growth rate of the business and the relative competitive position of the firm identified by the market share. Businesses in the "question marks" quadrant, with a weak market share and a high growth rate, usually require cash investment so that they can become "stars," the businesses in the high-growth, strongly competitive position. These kinds of businesses have opportunities for growth and profit. The "cash cows," with a strong competitive position and a low growth rate, are usually well established in the market and such enterprises are in a position to make their products at low costs. Therefore, their products provide the cash needed for their operation. The "dogs" are businesses with a low growth rate and a weak market share. These businesses are usually not profitable and generally should be disposed of.

The portfolio matrix was developed for large corporations with several divisions that are often organized around strategic business units (a topic to be discussed in Chapter 8). While portfolio analysis was popular in the 1970s, it is not without its critics, who contend that it is too simplistic. Also, the growth rate criterion has been considered insufficient for the evaluation of an industry's attractiveness. Similarly, the market share as a yardstick for estimating the competitive position may be inadequate.

**Figure 5.2**

**Business Portfolio Matrix.**

**Adapted from *The Product Portfolio Matrix,* copyright © 1970, The Boston Consulting Group, Inc.**






## MAJOR KINDS OF STRATEGIES AND POLICIES

For a business enterprise (and, with some modification, for other kinds of organizations as well), the major strategies and policies that give an overall direction to operation are likely to be in the areas of growth, finance, organization, personnel, public relations, products or services, and marketing. We will elaborate on the last two areas.

### Products or Services

A business exists to furnish products or services. In a very real sense, profits are merely a measure, although an important one, of how well a company serves its customers. New products or services, more than any other single factor, determine what an enterprise is or will be.

The key questions in this area can be summarized as follows:

- What is our business?
- Who are our customers?
- What do our customers want?
- How much will our customers buy and at what price?
- Do we wish to be a product leader?
- What is our competitive advantage?
- Do we wish to develop our own new products?
- What advantages do we have in serving customer needs?
- How should we respond to existing and potential competition?
- How far can we go in serving customer needs?
- What profits can we expect?
- What basic form should our strategy take?

LEADERSHIP PERSPECTIVE

### Leadership Succession at the Tata Group?[20]

The Tata Group is India's biggest conglomerate. The big three parts are Tata Steel, Tata Motors, and Tata Consulting Services. The group invested heavily in cars, steel, power, chemicals, and other products. To develop a more focused strategy, Tata sold the cosmetics, paint, and cement groups while entering new businesses in retail, biotech, telecom, and others.

Still, Tata faces several challenges. One is to build a coherent vision while being in many different markets and industries. It is indeed a challenge to formulate strategies for almost 100 companies with some 300 subsidiaries in 40 different businesses. Another challenge is how to absorb the struggling Corus mills. With the high demand for energy, Tata focuses on the future by engaging in a low-cost solar project. Other challenges for the future are to decide which businesses to spin-off and which to pursue. Also what would happen if the economy slows? Still, and perhaps the most challenging issue is what would happen when the very energetic and visionary leader, Chairman of the Tata Group Mr. Ratan N. Tata, would retire?

■■

## Marketing

Marketing strategies are designed to guide managers in getting products or services to customers and in encouraging customers to buy. Marketing strategies are closely related to product strategies; they must be interrelated and mutually supportive. As a matter of fact, Peter Drucker regards the two basic business functions as innovation (e.g., the creation of new goods or services) and marketing. A business can scarcely survive without at least one of these functions and preferably both.

The key questions that serve as guides for establishing a marketing strategy are these:

- Where are our customers, and why do they buy?
- How do our customers buy?
- How is it best for us to sell?
- Do we have something to offer that competitors do not?
- Do we wish to take legal steps to discourage competition?
- Do we need, and can we supply, supporting services?
- What are the best pricing strategy and policy for our operation?
- How can we best serve our customers?

LEADERSHIP PERSPECTIVE

### Buying Skype, eBay's Mistake?[21]

Skype was founded by a Dane and a Swede with software developed by two Estonians. Skype uses the voice-over Internet Protocol, and allows communication by voice, video and instant messaging through the use of the Internet. At low cost, calls can also be made to landline and mobile phones; group video calling is also possible.

eBay, known for being the online market place where sellers and buyers come to trade almost anything, acquired Skype at a high price; it may have been a mistake by the otherwise very successful Margaret Whitman, eBay's CEO. Skype's internet venture was a new phenomenon in 2005. However, by 2007/2008 Skype was not the success as it was envisioned. The integration with eBay's main business was not done well. Perhaps even more important was Google's entry into the market enabling people to find buyers for their goods. Moreover, Google began providing online payment and telephone services that compete with eBay's PayPal. In 2011, Microsoft acquired Skype Communication and became a division of Microsoft. Millions of people around the world take advantage of the free or low-cost service which is also used increasingly by teachers and schools in educational projects. ■■



## HIERARCHY OF COMPANY STRATEGIES

In large, diversified companies, the overall strategy may take the form of a hierarchy. At the top of the pyramid is the *corporate-level strategy*. At this level, executives craft the overall strategy for a diversified company. Decisions are made as to the industries in which the company wants to compete. A portfolio of businesses is often selected to achieve synergies among the business units.

The second level in the hierarchy is *business strategies*, which are usually developed by the general manager of a business unit. These strategies are reviewed and approved or rejected by the chief executive. The aim of the business strategy is to gain a competitive advantage in a particular area of product line.

On the third hierarchical level, *functional strategies* (or policies) are developed. These strategies are devised for departments or other organizational units, such as finance, production, marketing, service, and personnel. The aim is to support the business and corporate strategies.

## PORTER'S INDUSTRY ANALYSIS AND GENERIC COMPETITIVE STRATEGIES[22]

Professor Michael Porter suggests that strategy formulation requires an analysis of the attractiveness of an industry and the company's position within that industry. This analysis becomes the basis for formulating generic strategies.

## Industry Analysis[23]

In the analysis of the industry, Porter identified five forces: (1) the competition among companies, (2) the threat of new companies entering the market, (3) the possibility of using substitute products or services, (4) the bargaining power of suppliers, and (5) the bargaining power of buyers or customers. On the basis of the industry analysis, a company may adopt generic strategies. These strategies are generic because they may be suitable on a broad level for different kinds of organizations. Any enterprise, however, may use more than one strategy.

## Overall Cost Leadership Strategy

This strategic approach aims at reduction in costs, based to a great extent on experience. Thus, the emphasis may be on keeping a close watch on costs in areas such as research and development, operation, sales, and service. The objective is for a company to have a low-cost structure compared with its competitors. This strategy often requires a large relative market share and cost-efficient operation, as illustrated by the low-cost Ivory soap sold in a broad market.

## Differentiation Strategy

A company following a differentiation strategy attempts to offer something unique in the industry in terms of products or services. Porsche sports cars are indeed special; so is the Caterpillar Company, which is known for its prompt service and availability of spare parts. In the broad consumer market, Dial soap is differentiated from other brands of soap by its use of deodorants.

## Focused Strategy

A company adopting a focused strategy concentrates on special groups of customers, a particular product line, a specific geographic region, or other aspects that become the focal point of the firm's efforts. Rather than serving the entire market with its products or services, an enterprise may emphasize a specific segment of the market. A low-cost strategy, differentiation, or both may accomplish this. Porter illustrates the *focused low-cost strategy* with the example of La Quinta Inns, a motel chain that operates in a certain region of the United States and appeals to traveling business representatives, such as salespeople. The *focused differentiation strategy* may be exemplified by Cray Research Inc., which specializes in very powerful and sophisticated supercomputers. The differentiation allows the company to charge premium prices.

In general, a company needs to choose a generic strategy and should not "get stuck in the middle," according to Porter. A company that gets stuck in the middle needs to decide on a low-cost strategy in a broad or narrow market or offer a differentiated (i.e., unique) product or service in a broad or narrow market.

## PREMISING AND FORECASTING

**Planning premises** The anticipated environment in which plans are expected to operate.

One of the essential and often overlooked steps in effective and coordinated planning is premising, which is the establishment of and the agreement by managers and planners to utilize consistent assumptions critical to plans under consideration. **Planning premises** are defined as the anticipated environment in which plans are expected to operate. They include assumptions or forecasts of the future and known conditions that will affect the operation of plans.[24] Examples are prevailing policies and existing company plans that control the basic nature of supporting plans.

A distinction should be drawn between forecasts that are planning premises and forecasts that are translated into future expectancies, usually in financial terms, from actual plans developed. For example, a forecast to determine future business conditions, sales volume, or political environment furnishes premises on which to develop plans. However, a forecast of the costs or revenues from a new capital investment translates a planning program into future expectations. In the first case, the forecast is a prerequisite of planning; in the second case, the forecast is a result of planning.

At the same time, plans themselves and forecasts of their future effects often become premises for other plans. The decision by an electricity company to construct a nuclear generating plant, for example, creates conditions that give rise to premises for transmission line plans and other plans necessarily dependent on the generating plant being built.



### Environmental Forecasting

If the future could be forecast with accuracy, planning would be relatively simple. Managers would need only to take into account their human and material resources and their opportunities and threats, compute the optimum method of reaching their objective, and proceed with a relatively high degree of certainty toward it. In practice, forecasting is much more complicated.

**Values and areas of forecasting** Forecasting has values aside from its use. First, the making of forecasts and their review by managers compel thinking ahead, looking to the future, and providing for it. Second, preparation of the forecast may disclose areas where necessary control is lacking. Third, forecasting, especially when there is participation throughout the organization, helps unify and coordinate plans. By focusing attention on the future, it assists in bringing a singleness of purpose to planning.

The environmental areas that are frequently chosen for making forecasts include the economic, social, political/legal, and technological environments.

www.rand.org

**Forecasting with the Delphi technique** One of the attempts to make technological forecasting more accurate and meaningful is the Delphi technique. This technique, developed by Olaf Helmer and his colleagues at the RAND Corporation, has a degree of scientific respectability and acceptance. A typical process of the Delphi technique is as follows:

1. A panel of experts on a particular problem area is selected, usually from both inside and outside the organization.

2. The experts are asked to make (anonymously, so that they will not be influenced by others) a forecast as to what they think will happen, and when, in various areas of new discoveries or developments.
3. The answers are compiled, and the composite results are fed back to the panel members.
4. With this information at hand (but still with individual anonymity), further estimates of the future are made.
5. This process may be repeated several times.
6. When a convergence of opinion begins to evolve, the results are then used as an acceptable forecast.

Note that the purpose of the successive opinions and feedback is not to force the experts to compromise but rather, by bringing additional informational inputs to bear, to make opinions more informed. It is thus hoped, and experience has verified this hope, that an informed consensus among experts will be arrived at.

## SUMMARY

There are different definitions of strategy. A comprehensive one refers to the determination of the firm's mission or purpose and its basic long-term objectives, followed by the adoption of courses of action and allocation of resources necessary to achieve these aims. Policies are general statements or understandings that guide managers' thinking in decision-making. Both strategies and policies give direction to plans. They provide the framework for plans and serve as a basis for the development of tactics and other managerial activities.

The strategic planning model shows how the process works. It identifies the critical elements of this process and indicates how they relate to each other. The TOWS Matrix is a modern tool for analyzing the threats and opportunities in the external environment and their relationships to the organization's internal weaknesses and strengths. Three TOWS Matrices have to be developed for mergers, acquisitions, joint ventures, and alliances. The portfolio matrix is a tool for allocating resources, linking the business growth rate with the relative competitive position (measured by market share) of the firm.

The blue ocean strategy focuses on the market space with no serious competition. In contrast, the red ocean strategy engages competitors in a bloody fight.

Major kinds of strategies and policies need to be developed in areas such as growth, finance, organization, personnel, public relations, products or services, and marketing. Strategies form a hierarchy from the corporate level to the business level and the functional level. Porter identified three generic competitive strategies related to overall cost leadership, differentiation, and focus.

Planning premises are the anticipated environment. They include assumptions or forecasts of the future and known conditions. More recently, environmental forecasting has become important. One approach to forecasting is the Delphi technique developed by the RAND Corporation.

## KEY IDEAS AND CONCEPTS FOR REVIEW

- ✔ Strategy
- ✔ Policy
- ✔ Tactics
- ✔ Key elements in the strategic planning process
- ✔ TOWS Matrix by Weihrich
- ✔ TOWS Merger Matrix
- ✔ Blue Ocean Strategy
- ✔ Portfolio matrix by the Boston Consulting Group
- ✔ Major kinds of strategies
- ✔ Hierarchy of strategies
- ✔ Porter's generic strategies
- ✔ Planning premises
- ✔ Environmental forecasting
- ✔ Delphi technique



## FOR DISCUSSION

1. How can you distinguish between strategies and policies?
2. Are strategies and policies as important in a non-business enterprise (such as a labor union, a government department, a hospital, or a city fire department) as they are in a business? Why and how?
3. Why are contingency plans important?
4. Choose an organization that you know and identify its strengths and weaknesses. What are its special opportunities and threats in the external environment?
5. How would you make an organizational appraisal of your college or university? What kind of "business" is the school in?
6. How can strategies be implemented effectively?
7. Identify major premises that, in your judgment, Honda Motor Company would need in order to forecast its sales of automobiles for the next two years.

## EXERCISES/ACTION STEPS

1. Read two articles that deal with strategy in magazines such as *Fortune* or *Business Week*. List the strengths and weaknesses of a company reported as well as the opportunities and threats faced by the firm.
2. Take a major decision problem facing you and outline the more critical planning premises surrounding it. How many of these are matters of knowledge and how many are matters of forecast? How many are qualitative and how many are quantitative? How many are within your control?

## INTERNET RESEARCH

1. The TOWS Matrix has been used for developing alternative strategies for organizations, for analyzing the competitive advantages of nations, as well as for developing a career strategy. Search the Internet for the "TOWS Matrix" and identify the application of the matrix.
2. Search the Internet for the term "strategic intent" and compare the intents of four organizations.
3. Search the Internet for "Competing for the Future" and find reviews of the book by that name by Hamel and Prahalad.

## International Case TATA's $2,500 People's Car is Here[25]

In Mid-2008, Tata Motors unveiled the much-talked-about $2,500 car at the 9th Auto Expo in New Delhi. The company is the largest Indian automobile firm and ranks number 2 in passenger cars. It also produces trucks and buses being sold in various parts of the world. The company also has a joint venture with Fiat.

The people's car could change the automobile industry not only in India, but in many other countries as well. The car to be officially launched in the latter part of 2008 is a four door, four-to-five-seater with a 30 horsepower, two-cylinder car. The estimated 54 US miles per gallon car comes at the time when oil sells for over $140 per barrel. The People's Car by the name of Nano will raise some eyebrows if not law suits by Apple Computer which carries a Nano model in its iPod selection.

The just over three meter long car is considered stylish as well as comfortable. It will be available in different colors in a standard and deluxe kind. The fuel-efficient small 623 cc engine delivers 33 horsepowers. The people's car is not only environment-friendly; it also meets India's safety requirements.

**Questions**

1. Would the Nano fit your needs? Would you consider buying the Nano? Why or why not?
2. What do you like about the car?
3. What do you dislike?
4. In what other countries would there me an interest in buying the Nano?

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# MAJOR PRINCIPLES OR GUIDES FOR THE MANAGERIAL FUNCTION OF PLANNING

Although a complete set of empirically proven, interrelated principles have not been discovered and codified, experience and observation of managing indicate certain fundamental managerial principles or guides. They not only provide managers with a conceptual scheme but also indicate to scholars the areas for research. To be sure, the key abstractions need to be applied with due consideration for the situation; and this is an art. In this closing section of planning, the principles, which perhaps would be more appropriately called guides to management, are organized (as this book is) according to the managerial functions of planning, organizing, staffing, leading, and controlling. In this part closing, the focus is on planning.

Each principle is given a number with a letter that represents the type of managerial function. The letter "P" below indicates that the principle pertains to an aspect of planning.

## Major Principles or Guides for Planning

The most essential guiding principles for planning are the following:

## The Purpose and Nature of Planning

The purpose and nature of planning may be summarized by reference to the following principles:

| | | |
|---|---|---|
| P1. | *Principle of contribution to objective* | The purpose of every plan and all supporting plans is to promote the accomplishment of enterprise objectives. |
| P2. | *Principle of objectives* | If objectives are to be meaningful to people, they must be clear, attainable, and verifiable. |
| P3. | *Principle of primacy of planning* | Planning logically precedes all other managerial functions. |
| P4. | *Principle of efficiency of plans* | The efficiency of a plan is measured by the amount it contributes to purpose and objectives offset by the costs required to formulate and operate it and by unsought consequences. |

## The Structure of Plans

Two major principles dealing with the structure of plans can go far in tying plans together, make supporting plans contribute to major plans and ensure that plans in one department harmonize with those in another.

| | | |
|---|---|---|
| P5. | *Principle of planning premises* | The more thoroughly individuals charged with planning understand and agree to uti- |

| | | |
|---|---|---|
| | | lize consistent the planning premises, more the coordinated enterprise planning will be. |
| P6. | *Principle of the strategy and policy framework* | The more strategies and policies are clearly understood and implemented in practice, more consistent and effective will be the framework of enterprise plans. |



## The Process of Planning

Within the process of planning, there are four principles that help in the development of a practical science of planning.

| | | |
|---|---|---|
| P7. | *Principle of the limiting factor* | In choosing among alternatives, the more accurately individuals recognize and allow for factors that are limiting or critical to the attainment of the desired goal, more easily and accurately can they select the most favorable alternative. |
| P8. | *The commitment principle* | Logical planning should cover a period of time in the future necessary to foresee as well as possible, through a series of actions, the fulfillment of commitments involved in a decision made today. |
| P9. | *Principle of flexibility* | Building flexibility into plans will lessen the danger of losses incurred through unexpected events but the cost of flexibility should be weighed against its advantages. |
| P10. | *Principle of navigational change* | The more that planning decisions commit individuals to a future path, the more important it becomes to check on events and expectations periodically and redraw plans as necessary to maintain a course toward a desired goal. |

The commitment principle and the principles of flexibility and navigational change are aimed at a contingency approach to planning. Although it makes sense to forecast and draw plans far enough into the future to be reasonably sure of meeting commitments, it is often impossible to do. The future might also be so uncertain that it becomes too risky to fulfill those commitments.

The principle of flexibility deals with the ability to change plans necessitated by unexpected events. The principle of navigational change, on the other hand, implies reviewing plans from time to time and redrawing them if this is required by changed events and expectations. Unless plans have built-in flexibility, navigational change may be difficult or costly.

# 6 Decision-Making

PART 2

## CHAPTER OBJECTIVES

After studying this chapter, you should be able to:

- Analyze decision-making as a rational process
- Develop alternative courses of action with consideration of the limiting factor
- Evaluate alternatives and select a course of action from among them
- Differentiate between programmed and non-programmed decisions
- Understand the differences between decisions made under conditions of certainty, uncertainty, and risk
- Recognize the importance of creativity and innovation in managing

**Decision-making** The selection of a course of action from among alternatives.

**Decision-making** is defined as the selection of a course of action from among alternatives; it is at the core of planning. A plan cannot be said to exist unless a decision—a commitment of resources, direction, or reputation—has been made. Until that point, there are only planning studies and analyses. Managers sometimes see decision-making as their central job because they must constantly choose what is to be done, who is to do it, and when, where, and occasionally even how it will be done. Decision-making is, however, only a step in planning. Even when it is done quickly and with little thought or when it influences action for only a few minutes, it is part of planning. It is also part of everyone's daily life. A course of action can seldom be judged alone because virtually every decision must be geared to other plans.

## THE IMPORTANCE AND LIMITATIONS OF RATIONAL DECISION-MAKING

In the discussion of the steps in planning in Chapter 4, decision-making was considered a major part of planning. As a matter of fact, given an awareness of an opportunity and a goal, the decision-making process is really the core of planning. Thus, in this context, the process leading to making a decision might be thought of as (1) premising, (2) identifying alternatives, (3) evaluating alternatives in terms of the goal sought, and (4) choosing an alternative, that is, making a decision.

Although this chapter emphasizes the logic and techniques of choosing a course of action, the discussion will show that decision-making is really one of the steps in planning.

## Rationality in Decision-Making

It is frequently said that effective decision-making must be rational. But what is rationality? When is a person thinking or deciding rationally?

People acting or deciding rationally are attempting to reach some goal that cannot be attained without action. They must have a clear understanding of alternative courses by which a goal can be reached under existing circumstances and limitations. They also must have the information and the ability to analyze and evaluate alternatives in light of the goal sought. Finally, they must have a desire to come to the best solution by selecting the alternative that most effectively satisfies goal achievement.

People seldom achieve complete rationality, particularly in managing.[1] In the first place, since no one can make decisions affecting the past, decisions must operate for the future, and the future almost invariably involves uncertainties. In the second place, it is difficult to recognize all the alternatives that might be followed to reach a goal; this is particularly true when decision-making involves doing something that has not been done before. Moreover, in most instances, not all alternatives can be analyzed, even with the newest analytical techniques and computers available.

## Limited or "Bounded" Rationality

**Satisficing** Picking a course of action that is satisfactory or good enough under the circumstances.

A manager must settle for limited or "bounded" rationality. In other words, limitations of information, time, and certainty limit rationality, even if a manager tries earnestly to be completely rational. Since managers cannot be completely rational in practice, they sometimes allow their dislike of risk—their desire to "play it safe"—to interfere with the desire to reach the best solution under the circumstances. Herbert Simon[2] called this **satisficing**, which is, picking a course of action that is satisfactory or good enough under the circumstances. Although many managerial decisions are made with a desire to "get by" as safely as possible, most managers do attempt to make the best decisions they can within the limits of rationality and in light of the degree and nature of the risks involved.

**LEADERSHIP PERSPECTIVE**

### Decisions, Decisions, Decisions at American Airlines[3]

Leaders have to cope with unexpected situations. When a blizzard hit the U.S. East coast, many decisions were initiated. Let's just take one airline to illustrate such a situation. At the command center at American Airlines, hundreds of domestic and international flights are tracked. Information needs to be gathered from meteorologists, the visibility has to be checked, and local information has to be obtained

such as whether employees will be able to come to work, how many customers are booked on the various flights, which flights need to be cancelled or rerouted. Imagine the complexity of booking hundreds or thousands of passengers again. The weather also can affect equipment failure. The airline is also concerned about flight delays because the Federal Aviation Administration keeps a record of flights arriving late by 15 minutes or more. Flights also need to be coordinated with other airlines. Certainly, decision-makers are aided by computers, but many decisions have to be made by a person–a leader. Certainly customers will be affected, those on important business trips and those who planned a vacation perhaps years ago. Realizing the complexity of decisions, someone, a leader, has to make tough decisions in light of uncertainties. Therefore, decision-making is a very important managerial function. ■■



## DEVELOPMENT OF ALTERNATIVES AND THE LIMITING FACTOR

Assuming that we know what our goals are and agree on clear planning premises, the first step of decision-making is to develop alternatives. There are almost always alternatives to any course of action; indeed, if there seems to be only one way of doing a thing, that way is probably wrong. If we can think of only one course of action, clearly we have not thought hard enough.

The ability to develop alternatives is often as important as being able to select correctly from among them. On the other hand, ingenuity, research, and common sense will often unearth so many choices that none of them can be adequately evaluated. The manager needs help in this situation, and this help, as well as assistance in choosing the best alternative, is found in the concept of the limiting or strategic factor.

**Principle of the limiting factor** By recognizing and overcoming factors that stand critically in the way of a goal, the best alternative course of action can be selected.

A **limiting factor** is something that stands in the way of accomplishing a desired objective. Recognizing the limiting factors in a given situation makes it possible to narrow the search for alternatives to those that will overcome the limiting factors. The **principle of the limiting factor** states that, by recognizing and overcoming those factors that stand critically in the way of a goal, the best alternative course of action can be selected.

INTERNATIONAL PERSPECTIVE

### Human versus Machine Decision-Making—The Winner is?[4]

The contest between IBM computer software Watson and the best quiz show champions on Jeopardy was the first person vs. machine competition. Guess what? The computer won.

The successful quiz show Jeopardy began in 1964. Essentially, this answer-and-question format presents the contestants with hints in the form of an answer. The

contestant then must provide the response as a question. For example, in the Geography category "It's the only state lying south of the Tropic of Cancer," to be responded to with the question **'What is Hawaii?'**

Using the Jeopardy format, IBM Research developed the computer software called "Watson" with the objective to not only win the contest in the Jeopardy show, but, more importantly, introduce a new technology generation. Watson does not actually think, but gives answers to tricky statements. The objective of the Watson computer project is to understand and interact with natural language. It uses clusters of some 750 powerful computers containing information from sources such as the *World Book Encyclopedia, Wikipedia,* books from *Project Gutenberg* and other sources. Search engines, such as Google, do not answer questions, but rather use keywords to search for results.

Watson's technology is certainly going to be commercialized with many applications to be developed. IBM is planning to work together, for example, with the University of Maryland and Columbia University to develop a physician's assistant. Furthermore, IBM plans to work with *Nuance Communications*, the publisher of the popular speech recognition software *Dragon, Naturally Speaking.*

Watson's success at the Jeopardy quiz show shows the application of technology to unstructured problems that may have a great impact on managerial and other decision-making processes. ■■

## EVALUATION OF ALTERNATIVES

Once appropriate alternatives have been found, the next step in planning is to evaluate them and select the one that will best contribute to the goal. This is the point of ultimate decision-making, although decisions must also be made in the other steps of planning—in selecting goals, in choosing critical premises, and even in selecting alternatives.

### Quantitative and Qualitative Factors

**Quantitative factors** Factors that can be measured in numerical terms.

**Qualitative or intangible factors** Factors that are difficult to measure numerically.

In comparing alternative plans for achieving an objective, people are likely to think exclusively of **quantitative factors**. These are factors that can be measured in numerical terms, such as time or various fixed and operating costs. No one would question the importance of this type of analysis, but the success of the venture would be endangered if intangible or qualitative factors were ignored. **Qualitative or intangible factors** are factors that are difficult to measure numerically, such as the quality of labor relations, the risk of technological change, or the international political climate. There are all too many instances in which an excellent quantitative plan was destroyed by an unforeseen war, a fine marketing plan made inoperable by a long transportation strike, or a rational borrowing plan hampered by an economic recession. These illustrations point out the importance of giving attention to both quantitative and qualitative factors when comparing alternatives.

To evaluate and compare the intangible factors in a planning problem and make decisions, managers must first recognize these factors and then determine whether a reasonable quantitative measurement can be given to them. If not, they should find out as much as possible about the factors, perhaps rate them in terms of their importance, compare their probable influence on the outcome with that of the quantitative factors, and then come to a decision. This decision may give predominant weight to a single intangible.



**INTERNATIONAL PERSPECTIVE**

## The Battle of the Titans: Boeing vs. Airbus[5]

Many quantitative and qualitative factors had to be evaluated by Boeing and Airbus in their battle for leadership in the aircraft industry. Beginning around the year 2000, Airbus, a unit of the European Aeronautic Defense & Space Co. (EAD), was the leading aircraft maker over the American Boeing company. This may have resulted in overconfidence. The super-sized Airbus A380 was developed with the aim to overtake the Boeing 747, the 450-seat aircraft that had dominated the skies for many years. In 2006, however, the fortunes seemed to change.

The A380 production ran into trouble, resulting in delays at a very high cost for the company. Airbus underestimated the complexity of the big aircraft with its sophisticated equipment. The installation of communication and in-flight entertainment systems caused major problems. The shortage of qualified engineers made if difficult to introduce multiple models designed to compete with Boeing. The squabbles within Airbus's management did not help the company either.

Several airlines rethought their decisions with some airlines placing their orders with Boeing instead. Thai Airways, for example, was considering cancelling its orders of six planes. In December 2006, Lufthansa, a German airline, announced that it would buy the updated Boeing 747 jumbo jet which had dominated the jumbo jet market in the past. Singapore Airlines, an important buyer of new aircraft also ordered 20 Boeing 787 Dreamliners which was well received by the customers for its comfort and efficiency. The aircraft is less expensive to operate and to maintain than the competing Airbus A330. Consequently, Airbus developed the A350 in response to Boeing's 787. However, the Dreamliner is expected to be in service four years earlier than the A350 (2008 vs 2012).

To assist the troubled Airbus, the European Union plans to continue its support of the aircraft maker. Consequently, Boeing filed arguments with the World Trade Organization (WTO) suggesting that the subsidies paid for the development of Airbus planes were illegal. Boeing, on the other hand was accused of receiving state subsidies for developing new aircraft.

As the arguments play out in the courts, Airbus and Boeing continue their battle in the marketplace. The early domineering position of Boeing was followed by successes of Airbus beginning around the year 2000. In 2006-2007, however, the outlook for Boeing seems more favorable – so the battle of the titans continues. ■■

### Marginal Analysis

**Marginal analysis** Comparing the additional revenue and the additional cost arising from increasing output.

Evaluating alternatives may involve utilizing the technique of **marginal analysis** to compare the additional revenue and the additional cost arising from increasing output. Where the objective is to maximize profit, this goal will be reached, as elementary economics teaches, when the additional revenue and additional cost are equal. In other words, if the additional revenue of a larger quantity is greater than its additional cost, more profit can be made by producing more. However, if the additional revenue of the larger quantity is less than its additional cost, a larger profit can be made by producing less.

Marginal analysis can be used in comparing factors other than cost and revenue. For example, to find the best output of a machine, input could be varied against output until the additional input equals the additional output. This would then be the point of maximum efficiency of the machine. Or, the number of subordinates reporting to a manager might conceivably be increased to the point at which additional cost savings, better communication and morale, and other factors equal additional losses in the effectiveness of control, leadership, and similar factors.

### Cost-effectiveness Analysis

**Cost-effectiveness analysis** seeks the best ratio of benefit and cost.

An improvement on, or variation of, traditional marginal analysis is cost-effectiveness or cost–benefit analysis. **Cost-effectiveness analysis** seeks the best ratio of benefit and cost; this means, for example, finding the least costly way of reaching an objective or getting the greatest value for a given expenditure.

## SELECTING AN ALTERNATIVE: THREE APPROACHES

When selecting from among alternatives, managers can use three basic approaches: (1) experience, (2) experimentation, and (3) research and analysis (Figure 6.1).

### Experience

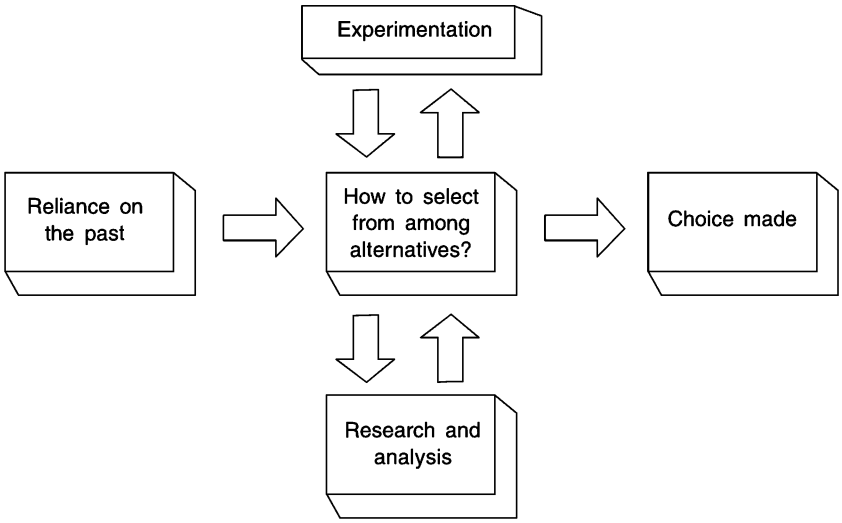
Reliance, on past experience, probably plays a larger part than it deserves in decision-making. Experienced managers usually believe, often without realizing it, that the things they have successfully accomplished and the mistakes they have made furnish, almost infallible guides to the future. This attitude is likely to be more pronounced the more experience a manager has had, and the higher he or she has risen in an organization.

To some extent, experience is the best teacher. The very fact that managers have reached their position appears to justify their past decisions. Moreover, the process of thinking problems through, making decisions, and seeing programs succeed or fail does make for a degree of good judgment (at times bordering on intuition). Many people, however, do not learn from their errors and there are managers who seem never to gain the seasoned judgment required by the modern enterprise.

Relying on past experience as a guide for future action can be dangerous. In the first place, most people do not recognize the underlying reasons for their mistakes or

**Figure 6.1**

**Bases for Selecting from among Alternative Courses of Action.**






failures. In the second place, the lessons of experience may be entirely inapplicable to new problems. Good decisions must be evaluated against future events, while experience belongs to the past.

On the other hand, if a person carefully analyzes experience, rather than blindly following it and if he or she distills from experience the fundamental reasons for success or failure, then experience can be useful as a basis for decision analysis. A successful program, a well-managed company, a profitable product promotion, or any other decision that turns out well may furnish useful data for such distillation. Just as scientists do not hesitate to build upon the research of others and would be foolish indeed merely to duplicate it, managers can learn much from others.

## Experimentation

An obvious way to decide among alternatives is to try one of them and see what happens. Experimentation is often used in scientific inquiry. People often argue that it should be employed more often in managing and that the only way a manager can make sure some plans are right—especially in view of the intangible factors—is to try the various alternatives and see which is best.

The experimental technique is likely to be the most expensive of all techniques, especially if a program requires heavy expenditures of capital and personnel and if the firm cannot afford to vigorously attempt several alternatives. Besides, after an experiment has been tried, there may still be doubt about what it proved, since the future may not duplicate the present. This technique, therefore, should be used only after considering other alternatives.

On the other hand, there are many decisions that cannot be made until the best course of action can be ascertained by experiment. Even reflections on experience or the most careful research may not assure managers of correct decisions. This is nowhere better illustrated than in the planning of a new airplane.

An airplane manufacturer may draw from personal experience and that of other plane manufacturers and new plane users. Engineers and economists may make extensive studies of stress, vibration, fuel consumption, speed, space allocation, and other factors. But all these studies do not answer every question about the flight characteristics and economics of a successful plane; therefore, some experimentation is almost always involved in the process of selecting the right course to follow. Ordinarily, a first-production, or prototype airplane, is constructed and tested; and on the basis of these tests, production airplanes are made according to a somewhat revised design.

Experimentation is used in other ways. A firm may test a new product in a certain market before expanding its sale nationwide. Organizational techniques are often tried in a branch office or plant before being applied over an entire company. A candidate for a management job may be tested in the job during the incumbent's vacation.

## Research and Analysis

One of the most effective techniques for selecting from alternatives when major decisions are involved is research and analysis. This approach means solving a problem by first comprehending it. It thus involves a search for relationships among the more critical of the variables, constraints, and premises that bear upon the goal sought. It is the pencil-and-paper (or, better, the computer-and-printout) approach to decision-making.

Solving a planning problem requires breaking it into its component parts and studying the various quantitative and qualitative factors. Study and analysis are likely to be far cheaper than experimentation. The hours of time and reams of paper used for analyses usually cost much less than trying the various alternatives. In manufacturing airplanes, for example, if careful research did not precede the building and testing of the prototype airplane and its parts, the resulting costs would be enormous.

A major step in the research-and-analysis approach is to develop a model simulating the problem. Thus, architects often make models of buildings in the form of extensive blueprints or three-dimensional renditions. Engineers test models of airplane wings and missiles in a wind tunnel. But the most useful simulation is likely to be a representation of the variables in a problem situation by mathematical terms and relationships. Conceptualizing a problem is a major step toward its solution. The physical sciences have long relied on mathematical models to do this, and it is encouraging to see this method being applied to managerial decision-making.

**INTERNATIONAL PERSPECTIVE**

### Boeing's Decision to Go Digital in Developing the 777[6]

www.boeing.com

Boeing's 777 airliner may be one of the most advanced aircraft in the world. The most innovative aspect, however, is the way the airliner was built: 100 percent three-dimensional digital design using CAD/CAM technology. To go digital was a critical decision for Boeing. Using the new system, engineers could see the design on screen and preassemble the plane's more than 3 million parts and its 132,500 uniquely engineered parts. This new approach, a paradigm shift, required completely new relationships with suppliers and customers. For example, the company requested ideas for the 777 from eight airlines. Internally, planners, engineers, and toolers worked together as a team and had current information on the development process. Previously, engineers and mechanics had to work on some full-scale mockups to see whether parts did or did not fit and problems would result in costly reworks. More recently, Boeing has begun using an advanced, intelligent CAD (called ICAD) system that makes major changes in the design possible. Now, and in the future, emerging technologies aid decision-making. ■■



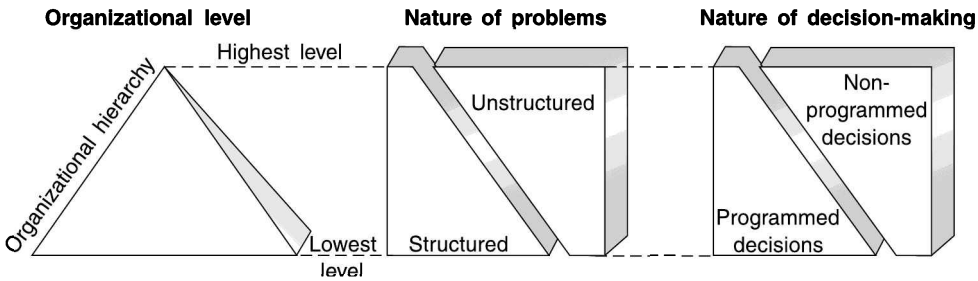
## PROGRAMMED AND NON-PROGRAMMED DECISIONS

**Programmed decisions** are used for structured or routine work.

A distinction can be made between programmed and non-programmed decisions. A **programmed decision**, as shown in Figure 6.2, is applied to structured or routine problems. Lathe operators, for instance, have specifications and rules that tell them whether the part they made is acceptable, has to be discarded, or should be reworked. Another example of a programmed decision is the reordering of standard inventory items. This kind of decision is used for routine and repetitive work; it relies primarily on previously established criteria. It is, in effect, decision-making by precedent.

**Figure 6.2**

**Nature of Problems and Decision-making in the Organization.**



**Non-programmed decisions** are used for unstructured, novel, and ill-defined situations of a non-recurring nature.

**Non-programmed decisions** are used for unstructured, novel, and ill-defined situations of a non-recurring nature. Examples are the introduction of the Macintosh computer by Apple or the development of the four-wheel-drive passenger car by Audi. In fact, strategic decisions, in general, are non-programmed decisions since they require subjective judgments.

Most decisions are neither completely programmed nor completely non-programmed; they are a combination of both. As Figure 6.2 indicates, most non-programmed decisions are made by upper-level managers; this is because upper-level managers have to deal with unstructured problems. Problems at lower levels of the organization are often routine and well structured, requiring less decision discretion by managers and non-managers.

LEADERSHIP PERSPECTIVE

### IBM's Louis Gerstner: A Leader and Decision-Maker[7]

At first, it might seem unlikely that a manager with a career at RJR Nabisco and American Express would be the person who could lead a technically oriented company like IBM out of its difficult 1993 position. Yet, this was precisely what Louis Gerstner did with two key decisions: first, he did not break up the company; and second, he focused on the service business. By 2001, its global business was the area with the fastest growth. Despite the demands on his time, he still took time for social causes, especially those related to schooling.

One of Gerstner's strategic decisions was in the server market, where Sun Microsystems had been dominant with its UNIX servers. IBM was able to lower its prices and therefore, put its competitors such as Sun, Hewlett-Packard, and Compaq under extreme pressure.

Thus, as a top-level manager, Gerstner had to balance his time resources between making strategic and tactical decisions, deciding on products and services, global and domestic planning, and strategy formulation and implementation, as well as balancing his energy between organizational and socially responsible actions. ■■

## DECISION-MAKING UNDER CERTAINTY, UNCERTAINTY, AND RISK

Virtually all decisions are made in an environment of at least some uncertainty. However, the degree varies from relative certainty to great uncertainty. There are certain risks involved in making decisions.

In a situation involving certainty, people are reasonably sure about what will happen when they make a decision. The information is available and is considered to be reliable, and the cause and effect relationships are known.

On the other hand, in a situation of uncertainty, people have only a meager database, they do not know whether or not the data are reliable, and they are very unsure about whether or not the situation may change. Moreover, they cannot

evaluate the interactions of the different variables. For example, a corporation that decides to expand its operation to an unfamiliar country may know little about the country's culture, laws, economic environment, and politics. The political situation may be so volatile that even experts cannot predict a possible change in government.

In a situation with risks, factual information may exist, but it may be incomplete. To improve decision-making, one may estimate the objective probability of an outcome by using, for example, mathematical models. On the other hand, subjective probability, based on judgment and experience, may be used.



LEADERSHIP PERSPECTIVE

## To Risk or Not to Risk – That is the Question for Tesla[8]

The need for energy independence directs the focus to electric cars. Tesla Motors, a California-based car company has been in the business of designing, manufacturing, and selling electric cars for many years. The Tesla Roadster was one of the first cars using the lithium-ion battery with a range of exceeding 200 miles. The car, it is said, will be much more energy efficient than the hybrid Prius by Toyota.

In 2010, Tesla entered the finance world through the public offering (IPO), being confident that the new sedan S Model will be successful. It is hoped that the S Model eventually will sell 20,000 a year. But Tesla faced many challenges, such as the 2010 weak car industry. Also the company needs additional cash and hopes for improved battery technology that could extend the driving range. The expected competition from companies such as Nissan[9] and Toyota which plans to offer a plug-in hybrid[10] are also a factor. General Motors, for example, developed the much-hyped Chevrolet Volt—a hybrid sedan. Moreover, Tesla does not seem to be quite clear whether it can become a high-volume car producer. Opportunites for an electric car are there, but the risk for Tesla is great. Tesla's hope is that the S Model sedan will succeed, thereby justifying the risky decision. ■■

All intelligent decision-makers dealing with uncertainty like to know the degree and nature of the risk they are taking in choosing a course of action. One of the deficiencies in using the traditional approaches of operations research for problem solving is that many of the data used in a model are merely estimates and others are based on probabilities. The ordinary practice is to have staff specialists come up with "best estimates."

Virtually every decision is based on the interaction of a number of important variables, many of which have an element of uncertainty but, perhaps, a fairly high degree of probability. Thus, the wisdom of launching a new product might depend on a number of critical variables: the cost of introducing the product, the cost of producing it, the capital investment that will be required, the price that can be set for the product, the size of the potential market, and the share of the total market that it will represent.

**INTERNATIONAL PERSPECTIVE**

## Was Disneyland Paris Built on the Wrong Assumptions?[11]

www.disneyland-paris.com

Assumptions are critical for making strategies; their importance can be illustrated by the decision to build Euro Disney, which was later called Disneyland Paris. The venture was planned in an uncertain environment and based on wrong assumptions. In the early days of this undertaking, from 1992 to 1994, the company lost more than $1 billion. Disney initially owned 49 percent of the venture, but its share was later reduced to 39 percent. So what went wrong? After all, the earlier move into Japan was very successful. Using the experiences with other ventures as the premises for the French Disneyland was precisely the problem. In the United States and Japan, the admission price was gradually raised after initial interest had been built. In contrast, Euro Disney started with an unsustainable entrance price of more than $40. This was very high in comparison with other theme parks. Consequently, the admission price had to be drastically reduced and then gradually increased. In 1996, the one-day adult admission was about $38. Nevertheless, the initial high price may have resulted in the loss of customers in the early years of operation.

Another flawed assumption was that people would stay on average four days in Disney's hotels. However, in 1993, the average stay was only two days. The theme park opened with about one-third of the rides found at Disney World in America. Thus, all the rides could be done in one day, requiring a shorter hotel stay.

The European tradition of having the main meal at noontime was not taken into consideration either. The available eating places were overcrowded at noon and underutilized at other times. Rather than wait, visitors left to eat outside the park. In the United States and Japan, people eat throughout the day, thus avoiding long lines in the restaurants.

The mix of merchandise purchases is also different in France from that in the United States: Europeans buy fewer high-margin items.

These few illustrations seem to indicate that Disney did not sufficiently test its premises for the Euro Disney venture. Using assumptions based on previous successes may prove to be very costly. A careful analysis of cultural habits and observations of other theme parks may have prevented making plans based on incorrect assumptions.

While Euro Disney was suffering, certain competitors prospered. Euro Park was one of them. It is a theme park smaller than Euro Disney, located in Germany close to the French and Swiss borders. While Euro Disney may not have considered the cultural differences, management at Euro Park was very familiar with European customs. In surveys, visitors were asked to rate cleanliness, price, hours, rides, special shows, and so on. The surveys indicated, for example, that French visitors like to bring their baskets with bread, cheese, and wine. So patrons are allowed to bring their own food to the park (which is not allowed at Disney). The admission price was also substantially lower than at Euro Disney. Euro Park was considering

building a hotel, but management realized that this would be a risky undertaking because it is a different kind of business, requiring competencies that are different from managing a theme park. ■■

## CREATIVITY AND INNOVATION[12]



**Creativity** The ability and power to develop new ideas.

**Innovation** The use of new ideas.

A distinction can be made between creativity and innovation. The term **creativity** usually refers to the ability and power to develop new ideas. **Innovation**, on the other hand, usually means the use of these ideas. In an organization, this can mean a new product, a new service, or a new way of doing things. Although this discussion centers on the creative process, it is implied that organizations not only generate new ideas but also translate them into practical applications.

Four phases of the **creative process**: unconscious scanning, intuition, insight, and logical formulation or verification.

### The Creative Process

The creative process is seldom simple and linear. Instead, generally it consists of four overlapping and interacting phases: (1) unconscious scanning, (2) intuition, (3) insight, and (4) logical formulation.

The first phase, *unconscious scanning*, is difficult to explain because it is beyond consciousness. This scanning usually requires an absorption in the problem, which may be vague in the mind. Yet managers working under time constraints often make decisions prematurely rather than dealing thoroughly with ambiguous, ill-defined problems.

www.gm.com

The second phase, *intuition*, connects the unconscious with the conscious. This stage may involve a combination of factors that may seem contradictory at first. For example, Donaldson Brown and Alfred Sloan of General Motors conceived the idea of a decentralized division structure with centralized control, concepts that seem to contradict each other. Yet the idea makes sense when one recognizes the underlying principles of (1) giving responsibility for the operations to the general manager of each division and (2) maintaining centralized control in headquarters over certain functions. It took the intuition of two great corporate leaders to see that these two principles could interact in the managerial process.

Intuition needs time to work. It requires that people find new combinations and integrate diverse concepts and ideas. Thus, one must think through the problem. Intuitive thinking is promoted by several techniques, such as brainstorming.

*Insight*, the third phase of the creative process, is mostly the result of hard work. For example, many ideas are needed in the development of a usable product, a new service, or a new process. What is interesting is that insight may come at times when the thoughts are not directly focused on the problem at hand. Moreover, new insights may last for only a few minutes, and effective managers may benefit from having paper and pencil ready to make notes of their creative ideas.

The last phase in the creative process is *logical formulation or verification*. Insight needs to be tested through logic or experiment. This may be accomplished by continuing to work on an idea or by inviting critiques from others. Brown and Sloan's idea of decentralization, for example, needed to be tested against organizational reality.

LEADERSHIP PERSPECTIVE

### Innovation in India: Microfinancing[13]

Innovation is not restricted to large companies with big research and development budgets. In India, the Self Help Groups (SHGs) consisting of some 12 to 15 women organize to get loans from large banks. While individuals would not obtain loans, the groups did. Group members discuss which project should be financed and how priorities should be set. These groups know the local environment well and can identify the needs and opportunities in the community. They also oversee how the money is used. Indeed the loan repayment rates are as high as 99.5 percent. This innovative microfinancing arrangement illustrates the decision and innovation at the lowest income level. ■■

## Brainstorming[14]

Creativity can be taught. Creative thoughts are often the fruits of extensive efforts. Some techniques focus on group interactions, others on individual actions.

One of the best-known techniques for facilitating creativity was developed by Alex F. Osborn, who has been called the father of brainstorming.[15] The purpose of this approach is to improve problem solving by finding new and unusual solutions. In the brainstorming session, a multiplication of ideas is sought. The rules are as follows:

- No ideas are ever criticized
- The more radical the ideas are the better
- The quantity of idea production is stressed
- The improvement of ideas by others is encouraged

Brainstorming, which emphasizes group thinking, was widely accepted after its introduction. However, the enthusiasm was dampened by research which showed that individuals could develop better ideas working by themselves than they could, by working in groups. Additional research, however, showed that in some situations the group approach may work well. This may be the case when the information is distributed among various people or when a poorer group decision is more acceptable than a better individual decision that, for example, may be opposed by those who have to implement it. Also, the acceptance of new ideas is usually greater when the decision is made by the group charged with its implementation.

INTERNATIONAL PERSPECTIVE

### Learning Innovation from Emerging Countries[16]

Companies learned that they could profit from selling low-priced products in other countries. General Electric's Healthcare Unit developed an electrocardiograph machine for doctors in China and India. Traditionally, innovations were first developed

in the U.S., Europe, and Japan. Now some of the innovations come from less developed countries. Indeed, some U.S. companies send their innovation managers to less developed countries. Research is now conducted abroad. For example, Hewlett-Packard has a research laboratory in India. Innovation can now originate in developed, developing, and even underdeveloped countries. ■■



## Limitations of Traditional Group Discussion

Although the technique of brainstorming may result in creative ideas, it would be incorrect to assume that creativity flourishes only in groups. Indeed, the usual group discussion can inhibit creativity. For example, group members may pursue an idea to the exclusion of other alternatives. Experts on a topic may not be willing to express their ideas in a group for fear of being ridiculed. Also, lower-level managers may be inhibited in expressing their views in a group with higher-level managers. Pressures to conform can discourage the expression of deviant opinions. The need for getting along with others can be stronger than the need for exploring creative but unpopular alternatives to the solution of a problem. Finally, because they need to arrive at a decision, groups may not make the effort of searching for data relevant to a decision.

**INTERNATIONAL PERSPECTIVE**

### How 3M Fosters Innovation[17]

www.jnj.com
www.rubbermaid.com
www.hp.com
www.dowcorning.com
www.ge.com
www.3m.com

Companies have different strategies for fostering innovation. At Johnson & Johnson, autonomous operating units are encouraged to innovate. The organization culture allows failure. At Rubbermaid, 30 percent of its sales are derived from products that are less than five years old. Hewlett-Packard encourages researchers to spend 10 percent of their time on their pet projects, and Merck allocates time and resources to its researchers for working on high-risk products with a potential for high payouts. Dow Corning and General Electric engage in joint projects with customers to develop new products. One of the masters in innovation is Minnesota Mining & Manufacturing (3M).

When one hears of 3M, one thinks of innovation. The organizational environment of 3M fosters creative thinking and a tolerance for new ideas. Although the financial performance in 1995 was not as good as before, the company met its goal of obtaining at least 30 percent of its sales from products that were less than four years old. Continual innovation is fostered by the 15 percent rule, which suggests that researchers spend 15 percent of their time on things that are not related to their main project.

The company is very decentralized. Its 8,300 researchers work in many different laboratories. This results in redundancy. In theory, the main labs and development centers should do research, while the others do the development. Often, however, it does not work this way. The company operates with few rules and does not have

a strategy in the traditional sense. Instead, it is guided by two things: (1) to be very innovative and (2) to satisfy the customer in every respect. Anything that hampers innovation, such as excessive planning or intolerance for mistakes, is eliminated. On the other hand, information sharing is required. Although financial measures act as a control, the real control comes from peers, who review each other's work.

The typical innovative process at 3M works as follows: When a person in the organization has an idea for a new product, he or she forms a team consisting of individuals from the functional areas, such as the technical department, manufacturing, marketing, sales, and, at times, finance. The company also encourages customers to contribute their ideas. The team works on product design, production, and marketing. Moreover, various uses of the product are explored. Team members are rewarded for the success of the product.

Rules or guidelines are rather simple: develop a tolerance for failure; reward those who have a good product idea and who can form an effective action team to promote the product; establish close relationships with customers; share technology with others in the company; keep the project alive by allocating time or financial grants; keep the divisions small.

The future will tell whether innovation will continue to be a key success factor for 3M. ■■

## The Creative Manager[18]

All too often, it is assumed that most people are non-creative and have little ability to develop new ideas. This assumption, unfortunately, can be detrimental to the organization, for in the appropriate environment virtually all people are capable of being creative, although the degree of creativity varies considerably between individuals.

Generally speaking, creative people are inquisitive and come up with many new and unusual ideas; they are seldom satisfied with the status quo. Although intelligent, they not only rely on the rational process but also involve the emotional aspects of their personality in problem solving. They appear to be excited about solving a problem, even to the point of tenacity. Creative individuals are aware of themselves and capable of independent judgment. They object to conformity and see themselves as being different.

It is beyond question that creative people can make great contributions to an enterprise. At the same time, however, they may also cause difficulties in organizations. Change—as any manager knows—is not always popular. Moreover, change frequently has undesirable and unexpected side effects. Similarly, unusual ideas, pursued stubbornly, may frustrate others and inhibit the smooth functioning of an organization. Finally, creative individuals may be disruptive by ignoring established policies, rules, and regulations. John Kao, who teaches at Harvard Business School, suggests that creative people should have enough freedom to pursue their ideas, but not so much that they waste their time or do not find enough time to collaborate with others on working toward common goals. He suggests that managers should view themselves as jazz musicians who follow a set of scores but have enough freedom for variations.[19]

As a result, the creativity of most individuals is probably under-utilized in many cases, despite the fact that unusual innovations can be of great benefit to the firm. However, individual and group techniques can be effectively used to nurture creativity, especially in the area of planning. Nonetheless, creativity is not a substitute for managerial judgment. It is the manager who must determine and weigh the risks involved in pursuing unusual ideas and translating them into innovative practices.



## Invention and Innovation[20]

**Invention** pertains to new ideas and process.

**Innovation** is the application of the ideas to products or services.

Invention alone is not sufficient for business success—it has to be followed by innovation. **Invention** pertains to new ideas and process and **innovation** is the application of the ideas to products or services. The Americans invented the VCR, but the Japanese effectively produced and distributed the product. Invention is discovery, finding something new.[21] Innovation, on the other hand, is using the idea and putting it into practice. Innovation is the realization of the idea. The IBM team was instructed not to invent the computer, but bring the off-the-shelf components together resulting in the IBM PC. Thus, it was innovation that resulted in the PC.[22]

## SUMMARY

Decision-making is the selection of a course of action from among alternatives; it is the core of planning. Managers must make choices on the basis of limited, or bounded, rationality—that is, in light of everything they can learn about a situation, which may not be everything they should know. *Satisficing* is a term sometimes used to describe picking a course of action that is satisfactory under the circumstances.

Because there are almost always alternatives—usually many—to a course of action, managers need to narrow them down to those few that deal with the limiting factors. These are the factors that stand in the way of achieving a desired objective. Alternatives are then evaluated in terms of quantitative and qualitative factors. Other techniques for evaluating alternatives include marginal analysis and cost-effectiveness analysis. Experience, experimentation, and research and analysis come into play in selecting an alternative.

Programmed and non-programmed decisions are different. The former are suited for structured or routine problems. These kinds of decisions are made especially by lower-level managers and nonmanagers. Non-programmed decisions, on the other hand, are used for unstructured and non-routine problems and are made especially by upper-level managers.

Virtually all decisions are made in an environment of at least some uncertainty involving the interaction of a number of important variables, and there are certain risks involved in making decisions. Managers dealing with uncertainty should know the degree and nature of the risk they are taking in choosing a course of action.

Creativity, the ability and power to develop new ideas, is important for effective managing. Innovation is the use of these ideas. The creative process consists of four overlapping phases: unconscious scanning, intuition, insight, and logical formulation. A popular technique for enhancing creativity is brainstorming. Creative individuals can make a great contribution to the enterprise. At the same time, they can be disruptive by not following commonly accepted rules of behavior.

## KEY IDEAS AND CONCEPTS FOR REVIEW

- ✔ Decision-making
- ✔ Limited or bounded rationality
- ✔ Satisficing
- ✔ Principle of the limiting factor
- ✔ Quantitative factors
- ✔ Qualitative factors
- ✔ Marginal analysis
- ✔ Cost-effectiveness analysis
- ✔ Three approaches to selecting an alternative
- ✔ Programmed decisions
- ✔ Non-programmed decisions
- ✔ Decision-making under certainty, uncertainty, and risk
- ✔ Creativity
- ✔ Innovation
- ✔ Creative process
- ✔ Brainstorming
- ✔ Creative manager
- ✔ Invention and Innovation

## FOR DISCUSSION

1. Why is experience referred often not only as an expensive basis for decision-making but also as a dangerous one? How can a manager make the best use of experience?
2. In a decision problem you now know of, how and where would you apply the principle of the limiting factor? Did you apply this principle in selecting the class or section of the class you are attending? In which ways?
3. Identify five decision problems and recommend programmed or non-programmed decisions. If the examples are from an organizational setting, did they occur at upper or lower levels?
4. "Decision-making is the primary task of the manager." Comment.
5. Think of a problem that was creatively solved. Did the solution come from group discussion, or was it the result of an individual effort? Reconstruct the phases of the creative process.
6. What is the difference between invention and innovation?

## EXERCISE/ACTION STEPS

Your boss offers you a promotion to a position in a location that your family does not like. Make the necessary assumptions and then state how and what you would decide.

## INTERNET RESEARCH

1. Search the Internet for "creativity" and illustrate how creativity can be applied to decision-making.
2. Find three applications of brainstorming on the Internet.



## International Case Carrefour—Which Way to Go?[23]

Wal-Mart's biggest global competitor is the big French retailer Carrefour, a firm that has hypermarkets—big stores offering a variety of goods. It has made large investments around the globe in Latin America and China. But not all is well as competitors taking market share it its home market, for instance. There has been even speculation of a takeover by Wal-Mart or Tesco, an English chain. Mr. Barnard had been ousted after heading the company for 12 years and was replaced by José Luis Durán, who is of German-Spanish descent. Although the global expansion is cited by some as success, it may be even a big mistake. It withdrew from Japan and sold 29 hypermarkets in Mexico. Carrefour also had problems competing with Tesco in Slovakia and the Czech Republic. In Germany, the company faced tough competition from Aldi and Lidle—two successful discounters. On the other hand, it bought stores in Poland, Italy, Turkey, and opened new stores in China, South Korea, and Columbia. Carrefour has become more careful in selecting markets. The company is eager to enter the Indian market but found in late 2006 that Wal-Mart will do so as well.

In France, where Carrefour is well established, the company made the big mistake in its pricing policy. It probably started with the 1999 merger with Promodès (A French discount chain). Carrefour confused the French clientele by losing its low-cost image; whether the image can be changed remains to be seen. Mr. Duran, the new CEO since 2005, embarked on the new strategy by offering 15 percent new products in its hypermarkets and 10 percent in its supermarkets. Moreover, he wants to employ more staff, extend the operating hours in certain hypermarkets, cut prices, try small stores, and push down decision-making. Mr. Duran aims to stay only in countries where Carrefour is among the top retailers.

**Questions:**

1. How should Mr. Duran assess the opportunities in various countries around the world?
2. Should Carrefour adopt Wal-Mart's strategy of "low prices every day"? What would be the advantage or disadvantage of such a strategy?
3. How could Carrefour differentiate itself from Wal-Mart?
4. Identify cultures in selected countries that need to be considered in order to be successful.

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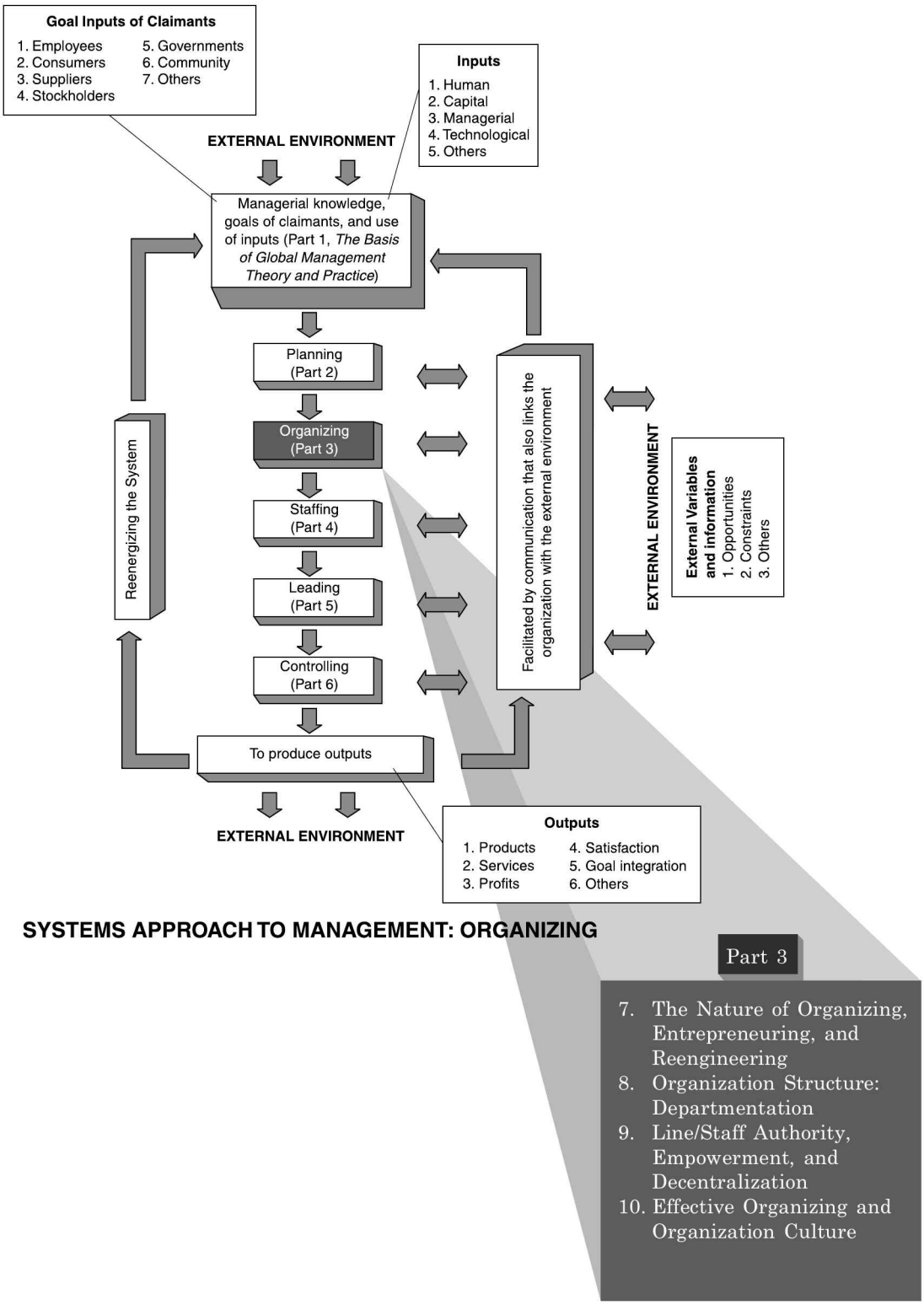

Goal Inputs of Claimants
1. Employees
2. Consumers
3. Suppliers
4. Stockholders
5. Governments
6. Community
7. Others
Inputs
1. Human
2. Capital
3. Managerial
4. Technological
5. Others
EXTERNAL ENVIRONMENT
Managerial knowledge, goals of claimants, and use of inputs (Part 1, The Basis of Global Management Theory and Practice)
Planning (Part 2)
Organizing (Part 3)
Staffing (Part 4)
Leading (Part 5)
Controlling (Part 6)
Reenergizing the System
Facilitated by communication that also links the organization with the external environment
EXTERNAL ENVIRONMENT
External Variables and information
1. Opportunities
2. Constraints
3. Others
To produce outputs
EXTERNAL ENVIRONMENT
Outputs
1. Products
2. Services
3. Profits
4. Satisfaction
5. Goal integration
6. Others
SYSTEMS APPROACH TO MANAGEMENT: ORGANIZING
Part 3
7. The Nature of Organizing, Entrepreneuring, and Reengineering
8. Organization Structure: Departmentation
9. Line/Staff Authority, Empowerment, and Decentralization
10. Effective Organizing and Organization Culture

# 7 The Nature of Organizing, Entrepreneuring, and Reengineering

## Chapter Objectives

After studying this chapter, you should be able to:

- Realize that the purpose of an organization structure is to establish a formal system of roles
- Understand the meaning of *organizing* and *organization*
- Draw a distinction between formal and informal organization
- Show how organization structures and their levels are due to the limitation of the span of management
- Recognize that the exact number of people a manager can effectively supervise depends on a number of underlying variables and situations
- Describe the nature of entrepreneuring and intrapreneuring
- Understand the key aspects and limitations of reengineering
- Demonstrate the logic of organizing and its relationship to other managerial functions
- Appreciate that organizing requires taking situations into account

It is often said that good people can make any organization structure work. Some people even assert that vagueness in organization is a good thing in that it forces teamwork, since people know that they must cooperate to get anything done. However, there can be no doubt that good people and those who want to cooperate will work together most effectively if they know the parts they are to play in any team operation and the way their roles relate to one another. This is as true in business or government as it is in football or in a symphony orchestra. Designing and maintaining these systems of roles is basically the managerial function of organizing.

For an **organizational role** to exist and be meaningful to people, it must incorporate (1) verifiable objectives, which, as indicated in Part 2, are a major part of planning; (2) a clear idea of the major duties or activities involved; and (3) an understood area of discretion or authority so that the person filling the role knows what he or she can do to accomplish goals. In addition, to make a role work out effectively, provision should be made for supplying needed information and other tools necessary for performance in that role.

It is in this sense that we think of **organizing** as:

- the identification and classification of required activities
- the grouping of activities necessary for attaining objectives
- the assignment of each group to a manager with the authority (delegation) necessary to supervise it
- the provision for coordination horizontally (on the same or a similar organizational level) and vertically (e.g., between corporate headquarters, division, and department) in the organization structure

An organization structure should be designed to clarify who is to do what tasks and who is responsible for what results in order to remove obstacles to performance caused by confusion and uncertainty of assignment and to furnish decision-making and communication networks reflecting and supporting enterprise objectives.

**Organization** A formalized intentional structure of roles or positions.

*Organization* is a word many people use loosely. Some would say it includes all the behaviors of all participants. Others would equate it with the total system of social and cultural relationships. Still others refer to an enterprise, such as the United States Steel Corporation or the Department of Defense, as an organization. But for most practicing managers, the term **organization** implies a formalized intentional structure of roles or positions. In this book, the term is generally used in reference to a formalized structure of roles, although it is sometimes used to denote an enterprise.

What does *intentional structure of roles* mean? In the first place, as already implied in the definition of the nature and content of organizational roles, people working together must fill certain roles. In the second place, the roles people are asked to fill should be intentionally designed to ensure that required activities are done and that activities fit together so that people can work smoothly, effectively, and efficiently in groups. Certainly, most managers believe they are organizing when they establish such an intentional structure.



## FORMAL AND INFORMAL ORGANIZATION

Many writers on management distinguish between formal and informal organization. Both types are found in organizations, as shown in Figure 7.1. Let us look at them in more detail.

### Formal Organization

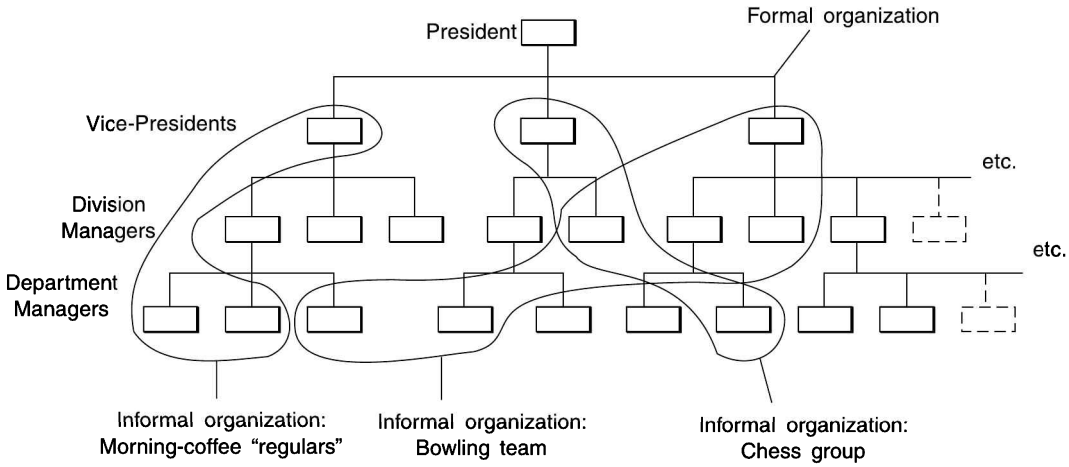
**Formal organization** The intentional structure of roles in a formally organized enterprise.

In this book, generally, **formal organization** means the intentional structure of roles in a formally organized enterprise. Describing an organization as formal, however, does not mean there is anything inherently inflexible or unduly confining about it. If a manager is to organize well, the structure must furnish an environment in which individual performance, both present and future, contributes most effectively to group goals.

A formal organization must be flexible. There should be room for discretion, for beneficial utilization of creative talents, and for recognition of individual likes and capacities in the most formal of organizations. Yet, individual effort in a group situation must be channeled toward group and organizational goals.

**Figure 7.1**

**Formal and Informal Organizations.**




## Informal Organization

**Informal organization** A network of interpersonal relationships that arise when people associate with each other.

Chester Barnard, author of the management classic *The Functions of the Executive*, described an informal organization as any joint personal activity without conscious joint purpose, although contributing to joint results.[1] It is much easier to ask for help on an organizational problem from someone you know personally, even if he or she may be in a different department, than from someone you know only as a name on an organization chart. The **informal organization** is a network of interpersonal relationships that arise when people associate with each other. Thus, informal organizations—relationships not appearing on an organization chart—might include the machine shop group, the sixth floor crowd, the Friday evening bowling gang, and the morning coffee "regulars."[2]

# ORGANIZATIONAL DIVISION: THE DEPARTMENT

One aspect of organizing is the establishment of departments. The word **department** designates a distinct area, division, or branch of an organization over which a manager has authority for the performance of specified activities. A department, as the term is generally used, may be the production division, the sales department, the West Coast branch, the market research section, or the accounts receivable unit. In some enterprises, departmental terminology is loosely applied; in others, especially large ones, a stricter terminology indicates hierarchical relationships. Thus, a vice president may head a division; a director, a department; a manager, a branch; and a chief, a section.

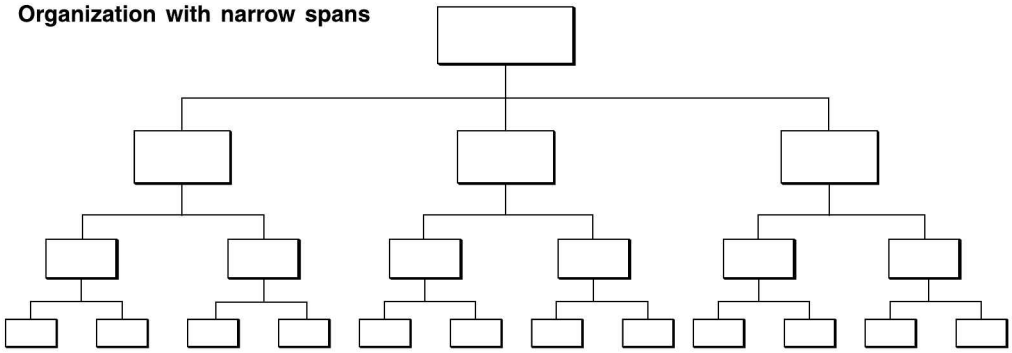
## ORGANIZATIONAL LEVELS AND THE SPAN OF MANAGEMENT*

While the purpose of organizing is to make human cooperation effective, the reason for levels of organization is the limitation of the span of management. In other words, organizational levels exist because there is a limit to the number of persons a manager can supervise effectively, even though this limit varies depending on situations. The relationships between the span of management and organizational levels are shown in Figure 7.2. A wide span of management is associated with few organizational levels; a narrow span, with many levels.

**Figure 7.1**

**Organization Structures with Narrow and Wide Spans.**

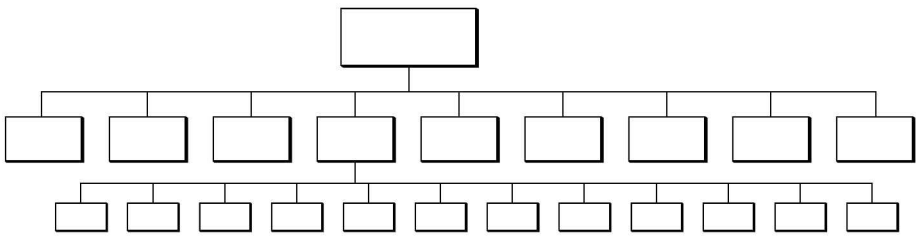
**Organization with narrow spans**



**Advantages**
- Close supervision
- Close control
- Fast communication between subordinates and superiors

**Disadvantages**
- Superiors tend to get too involved in subordinates' work
- Many levels of management
- High costs due to many levels
- Excessive distance between lowest level and top level

**Organization with wide spans**



**Advantages**
- Superiors are forced to delegate
- Clear policies must be made
- Subordinates must be carefully selected

**Disadvantages**
- Tendency of overloaded superiors to become decision bottlenecks
- Danger of superior's loss of control
- Requires exceptional quality of managers

*In much of the literature on management, this is referred to as the *span of control*. Despite the widespread use of this term, in this book *span of management* will be used, since the span is one of management and not merely of control, which is only one function of managing.

## Problems with Organizational Levels

There is a tendency to regard organization and departmentation as ends in themselves and to gauge the effectiveness of organization structures in terms of clarity and completeness of departments and departmental levels. The division of activities into departments and the creation of multiple levels are not completely desirable in themselves.

In the first place, levels are expensive. As they increase, more and more effort and money are devoted to managing because of the additional managers, the staff to assist them, and the necessity of coordinating departmental activities, as well as the cost of facilities for the personnel. Accountants refer to such costs as overhead, burden, or general and administrative, in contrast to so-called direct costs. Real production is accomplished by factory, engineering, or sales employees, who are, or could logically be accounted for as, "direct labor." Levels above the "firing line" are predominantly staffed with managers whose costs it would be desirable to eliminate, if that were possible.

In the second place, departmental levels complicate communication. An enterprise with many levels has greater difficulty communicating objectives, plans, and policies downward through the organization structure than does a firm in which the top manager communicates directly with employees. Omissions and misinterpretations occur as information passes down the line. Levels also complicate communication from the "firing line" to the commanding superiors, which is every bit as important as downward communication. It has been well said that levels are "filters" of information.

Finally, numerous departments and levels complicate planning and control. A plan that may be definite and complete at the top level loses coordination and clarity as it is subdivided at lower levels. Control becomes more difficult as levels and managers are added; at the same time, the complexities of planning and difficulties of communication make this control more important.

## The Operational Management Position: A Situational Approach

**Principle of span of management** There is a limit to the number of subordinates a manager can effectively supervise, but the exact number will depend on the impact of underlying factors.

The classical school approach to the span of management deals with specifying the number of subordinates for an effective span. Operational management theorists have taken the position that there are too many underlying variables in a management situation for us to specify any particular number of subordinates that a manager can effectively supervise. Thus, the **principle of span of management** states that there is a limit to the number of subordinates a manager can effectively supervise, but the exact number will depend on the impact of underlying factors.

In other words, the dominant current guideline is to look for the causes of limited span in individual situations rather than to assume that there is a widely applicable numerical limit. Examining what consumes the time of managers in their handling of superior-subordinate relationships and ascertaining devices that can be used to reduce these time pressures will be not only a helpful approach for determining the best span in individual cases but also a powerful tool for finding out what can be done to extend the span without destroying effective supervision. There can be no argument that the costs of levels of supervision make it highly desirable for every individual manager to have as many subordinates as can be effectively supervised.

## Factors Determining an Effective Span

The number of subordinates a manager can effectively manage depends on the impact of underlying factors. Apart from such personal capacities as comprehending quickly, getting along with people, and commanding loyalty and respect, the most important determinant is the manager's ability to reduce the time he or she spends with subordinates. This ability naturally varies with managers and their jobs, but several factors materially influence the number and frequency of such contacts and therefore the span of management, as shown in Table 7.1.

**Table 7.1** Factors Influencing the Span of Management

| *Narrow spans (a great deal of time spent with subordinates)* | *Wide spans (very little time spent with subordinates)* |
|---|---|
| • Little or no training of subordinates | • Thorough training of subordinates |
| • Inadequate or unclear authority delegation | • Clear delegation and well-defined tasks |
| • Unclear plans for nonrepetitive operations | • Well-defined plans for repetitive operations |
| • Non-verifiable objectives and standards | • Verifiable objectives used as standards |
| • Fast changes in external and internal environments | • Slow changes in external and internal environments |
| • Use of poor or inappropriate communication techniques, including vague instructions | • Use of appropriate techniques, such as proper organization structure and written and oral communication |
| • Ineffective interaction of superior and subordinate | • Effective interaction between superior and subordinate |
| • Ineffective meetings | • Effective meetings |
| • Greater number of specialties at lower and middle levels | • Greater number of specialties at upper levels (top managers concerned with external environment) |
| • Incompetent and untrained manager | • Competent and trained manager |
| • Complex task | • Simple task |
| • Subordinates' unwillingness to assume responsibility and reasonable risks | • Subordinates' willingness to assume responsibility and reasonable risks |
| • Immature subordinates | • Mature subordinates |



## Need for Balance

There can be no doubt that, despite the desirability of a flat organization structure, the span of management is limited by real and important restrictions. Managers may have more subordinates than they can manage effectively, even though they delegate authority, conduct training, formulate clear plans and policies, and adopt efficient control and communication techniques. It is equally true that, as an enterprise grows, limitations of the span of management force an increase in the number of levels simply because there are more people to supervise.

What is required is more precise balancing, in a given situation, of all pertinent factors. Widening spans and reducing the number of levels may be the answer in some cases; the reverse may be true in others. One must balance all costs of adopting one course or the other, not only financial but also costs in morale, personal development, and attainment of enterprise objectives. In a military organization, the attainment of objectives quickly and without error perhaps would be the most important objective. On the other hand, in a department store operation, the long-run objective of profit may be best served by forcing initiative and personal development at the lower levels of the organization.

## AN ORGANIZATIONAL ENVIRONMENT FOR ENTREPRENEURING AND INTRAPRENEURING[3]

www.intrapreneur.com

www.entrepreneur.com

At times, special organizational arrangements need to be made for fostering and utilizing entrepreneurship. Frequently, entrepreneurship is thought to apply to managing small businesses, but many authors now expand the concept to large organizations and to managers carrying out entrepreneurial roles through which they initiate changes to take advantage of opportunities. Although it is common to look for the "entrepreneurial personality" in people, Peter Drucker suggests that this search might not be successful.[4] Instead, one should look for a commitment to systematic innovation, which is a specific activity of entrepreneurs. The essence of entrepreneurship is innovation, that is, goal-oriented change to utilize the enterprise's potential. As entrepreneurs, managers try to improve the situation.

### The Intrapreneur and the Entrepreneur

**Intrapreneur** A person who focuses on innovation and creativity and who transforms a dream or an idea into a profitable venture by operating within an established organizational environment.

**Entrepreneur** A person who does similar things as the intrapreneur, but outside the organizational setting.

Gifford Pinchot makes a distinction between the intrapreneur and the entrepreneur.[5] Specifically, an **intrapreneur** is a person who focuses on innovation and creativity and who transforms a dream or an idea into a profitable venture by operating *within* the organizational environment. This notion is also sometimes referred to as corporate venturing. In contrast, the **entrepreneur** is a person who does similar things, but *outside* the organizational setting. Entrepreneurs have the ability to see an opportunity, obtain the necessary capital, labor and other inputs, and then put together an operation successfully. They are willing to take personal risk of success and failure. In this book, the term *entrepreneur* designates an enterprising person working either within or outside the organization.

**LEADERSHIP PERSPECTIVE**

### Marc Andreessen, the Co-Author of Mosaic and Co-Founder of Netscape Communications Corporation[6]

Andreessen is a software engineer, an entrepreneur, and an investor. He is the co-author of the first web browser Mosaic. He is also on the board of directors of

many companies including Hewlett Packard, eBay, and Facebook. He earned his Bachelor's degree at the University of Illinois at Urbana-Champaign and worked at the National Center for Supercomputing Applications where he became familiar with open standards for the World Wide Web.

He probably is best known for his vision of the potential of the web browser and was on the cover page of Time magazine. He is considered a model of the Internet bubble generation. More recently, he and his business partner, Ben Horowitz, formed the venture capital firm that invests in products, companies, and entrepreneurs in information enterprises. Marc Andreessen is both an entrepreneur and a visionary leader. ■■

## Creating an Environment for Entrepreneurship



Since it is a managerial responsibility to create an environment for effective and efficient achievement of group goals, managers must promote opportunities for entrepreneurs to utilize their potential for innovation. Entrepreneurs take personal risks in initiating change, and they expect to be rewarded for it. The taking of reasonable risk will, at times, result in failure, but this must be tolerated. Finally, entrepreneurs need some degree of freedom to pursue their ideas; this in turn requires that sufficient authority be delegated. The personal risks for entrepreneurs who have their own business are of a different kind, and failure may mean bankruptcy.

www.hp.com
www.apple.com
www.3m.com

Innovative persons often have ideas that are contrary to "conventional wisdom." It is quite common that these individuals are not well liked by their colleagues, and their contributions are often not sufficiently appreciated. It is therefore not surprising that many entrepreneurs leave large companies and start their own business. When Steve Wozniak could not get his dream of building a small computer fulfilled at Hewlett-Packard, he left that prestigious firm to form—together with another entrepreneur, Steve Jobs—Apple Computer. Progressive companies, such as 3M, consciously try to develop an organizational environment that promotes entrepreneurship within the company.

**LEADERSHIP PERSPECTIVE**

### What is in Your Future?[7]

Harvard professor John P. Kotter in his book *The New Rules: How to Succeed in Today's Post-Corporate World* surveyed the careers of 115 Harvard business graduates of 1974. Some of the findings are surprising. Many of the graduates left big businesses and joined smaller companies. Some who started in large firms switched to smaller firms. They felt that large companies were not open to their creative ideas for change, nor were they receptive to radical changes. In short, traditional big business firms may be stultifying people with new ideas. Kotter suggests that those with unconventional ideas often succeed. In the rapidly changing

environment, managers must search for new opportunities, but they must also avoid the hazards.

Small, entrepreneurial firms often present more opportunity for advancement, are more open to ambiguous situations, and provide the environment for exerting influence. Although many of the Harvard graduates surveyed preferred smaller firms, they may be connected to large firms as consultants, distributors, suppliers, financiers, or other roles.

What then are some of the implications for managers in carrying out managerial functions? Planning needs to be done in a less bureaucratic manner. A frequent scanning of the environment and a rapid response to changes are essential. Small companies, with a smaller hierarchical structure than large firms, may be more willing to change. With respect to staffing, graduates may want to explore the opportunities in smaller companies. The Harvard graduates who worked for small companies were not only better rewarded financially than those in large firms, but they were also rewarded through job satisfaction. ■■

## Innovation and Entrepreneurship[8]

When hearing about innovation and entrepreneurship, one thinks immediately of the success stories of people such as Steve Jobs of Apple Computer and Bill Gates of Microsoft. Entrepreneurs have creative ideas; they use their management skills and resources to meet identifiable needs in the marketplace. If successful, an entrepreneur can become wealthy. Peter Drucker suggests that innovation applies not only to high-tech companies but equally to low-tech, established businesses. Worthwhile innovation is not a matter of sheer luck; it requires systematic and rational work, well organized and managed for results.

What does entrepreneurship imply? It suggests dissatisfaction with how things are and an awareness of a need to do things differently. Innovation comes about because of some of the following situations:

- An unexpected event, failure, or success
- An incongruity between what is assumed and what really is
- A process or task that needs improvement
- Changes in the market or industry structure
- Changes in demographics
- Changes in meaning or in the way things are perceived
- Newly acquired knowledge

www.ge.com

Innovations based solely on bright ideas may be very risky and at times are not successful. General Electric's ambitious plans for the "factory of the future" may have been a costly mistake. These plans may have been based on unrealistic forecasts and unrealistic expectations for automating industry. The concept of the new factory expressed the wish of the chairperson, who wanted to promote entrepreneurship in an organization that was known to be highly structured.

The most successful innovations are often the mundane ones. Take certain Japanese automobile and electronic companies, who make minor innovations (e.g.,

providing little conveniences that customers like) in their cars or in their electronic equipment. Research has shown that successful large companies listen carefully to the needs of their customers. They establish teams that search for creative alternatives to serve their customers—but within a limiting framework and with clear goals in mind.

LEADERSHIP PERSPECTIVE

### Post-it Note Pads[9]

www.3m.com

Even in companies with a policy of promoting entrepreneurship and innovation, the development of new products requires perseverance in transforming an idea into reality.

Art Fry was singing in a church choir. The bookmarks placed in his hymnal fell out after the first church service, making it difficult to find the relevant pages for the second service. The need was clear: an adhesive paper slip that could be easily removed without damaging the page. However, developing an adhesive with the right degree of stickiness was not an easy task. 3M, where Art Fry worked, was known for products with great adhesion. For Art's purpose, however, a material was needed that not only provides sufficient adhesion but also allows easy removal. The 3M laboratory did not provide much help in the research and development of such a product. Nor did the marketing department think a great deal of this idea. But being an inventor as well as an innovator, Art Fry pursued his goal with great perseverance. The result was the Post-it note pad, which turned out to be a very profitable product for 3M. ■■



## REENGINEERING THE ORGANIZATION[10]

Some time ago, a managerial concept called reengineering entered management literature. It is sometimes called "starting over" because Michael Hammer and James Champy, who popularized the concept, suggested that one asks this question: "If I were recreating this company today (from scratch), knowing what I know now and given current technology, what would it look like?"[11]

More specifically, Hammer and Champy define reengineering as "the *fundamental* rethinking and *radical* redesign of business *processes* to achieve *dramatic* improvements in critical contemporary measures of performance, such as cost, quality, service, and speed."[12] The words in italics are considered key aspects by the authors.

### Key Aspects of Reengineering

Let us briefly consider these key aspects. First, hardly anyone would disagree on the need for a *fundamental rethinking* of what the organization is doing and why. One of the authors, while working as a systems analyst, found that systems and procedures were often outdated, inefficient, and completely unnecessary. Seldom

did systems users question why the procedures were necessary and the purpose they served. So a fresh look, especially by a "system's outsider," can indeed reveal much inefficiency. New thinking about management may provide a new perspective at what is being done and why.

The second key aspect in the definition is *radical redesign* of the business processes. In the original publication, the authors suggested that "radical" meant precisely that—not a modification but a reinvention. They also suggested that this is the most important aspect of their approach. Hammer and Champy, in a later paperback edition of the book, admit that they may have been wrong in suggesting that the most important key aspect is radical redesign.[13] Radical redesign often results in radical downsizing with detrimental effects to organizations.

Downsizing or "rightsizing" is not the primary purpose of reengineering, although in many cases it does result in fewer people being needed. Unfortunately, reengineering has primarily been used in a reactive way by managers' intent on reducing costs without necessarily addressing customer needs and expectations. Another result of radical redesigning is a business system based primarily on the engineering model without due considerations given to the human system. While radical redesign, accompanied by downsizing, may indeed result in short-term cost savings, it may also negatively affect the remaining workforce. Teamwork has become increasingly important in the modern organization. But team efforts are built on trust, and trust has to be built over a long period of time. With radical redesign, trust can be destroyed.

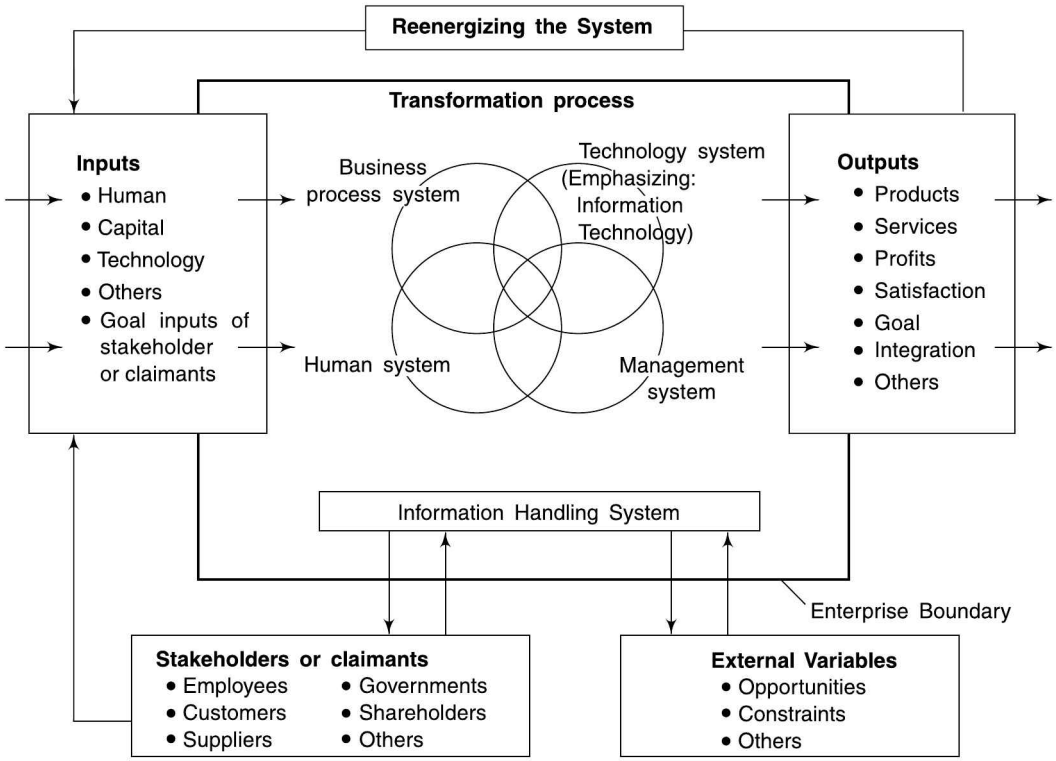
The third key term calls for *dramatic results*. Examples are often given to support this key aspect in the definition of reengineering that calls for dramatic improvements. Union Carbide cut $400 million from its fixed costs in three years. GTE, the Baby Bell telephone company, developed one-stop shopping; customers, who once had to deal with various departments, can now deal with one person, or they can connect directly with the department providing the specific service sought. But dramatic improvements are moderated by failures. Hammer and Champy admit that "some 50 to 70 percent of reengineering efforts fail to deliver the intended dramatic results."[14]

The fourth keyword in the reengineering definition is *processes*. The need for carefully analyzing and questioning business processes is indeed important. However, the process analysis must go beyond operations and must include the analysis and integration of technical systems, human systems, and the total management process including the linkage of the enterprise to the external environment. Engineers may focus on the business process; but to be truly effective, the various subsystems need to be integrated into a total system, as shown in Figure 7.3. The model indicates that the process of transforming the inputs into outputs must go beyond the business process system (the focus of reengineering) to include technological and human aspects, and indeed the total managerial system.

Despite the limitations, reengineering can be a powerful tool; but it is still only a tool. We suggest integrating reengineering with other systems through a new systems model called management by processes[15] to overcome some of the weaknesses of the narrowly focused reengineering approach.

**Figure 7.1**

**Management by Processes.**






**INTERNATIONAL PERSPECTIVE**

## Reengineering and Lean Production at Starbucks?[16]

Starbucks coffee houses were known of providing a relaxed atmosphere where customers could sip a cup of coffee in a relaxed manner. But, employees costing the company 24 percent in annual revenue may feel a little less relaxed. The emerging competition and the 2008-2009 recession led to a need for exploring approaches for improving Starbucks's efficiency. The company is, therefore, applying lean production concepts developed by the Japanese in the analysis of Starbucks's operation. A 10-member lean team is searching for ways to reduce costs and finding ways to improve the drink preparation and exploring other cost savings. The reengineering approach was initially used for analyzing the more complex operations of companies. Similarly, lean production concepts, first applied by the production of Toyota cars, are now applied in service operations such as Starbucks. ■■

# THE STRUCTURE AND PROCESS OF ORGANIZING

Looking at organizing as a process requires that several fundamentals be considered. In the first place, the structure must reflect objectives and plans because activities derive from them. In the second place, it must reflect the authority available to an enterprise's management. Authority in a given organization is a socially determined right to exercise discretion; as such, it is subject to change.

In the third place, an organization structure, like any plan, must reflect its environment. Just as the premises of a plan may be economic, technological, political, social, or ethical, so may be those of an organization structure. It must be designed to work, to permit contributions by members of a group, and to help people achieve objectives efficiently in a changing future. In this sense, a workable organization structure can never be static. There is no single organization structure that works best in all kinds of situations: an effective organization structure depends on the situation.

In the fourth place, since the organization is staffed with people, the grouping of activities and the authority relationships of an organization structure must take into account people's limitations and customs. This is not to say that the structure must be designed around individuals instead of around goals and accompanying activities. But an important consideration is the kinds of people who are to staff it.

## The Logic of Organizing

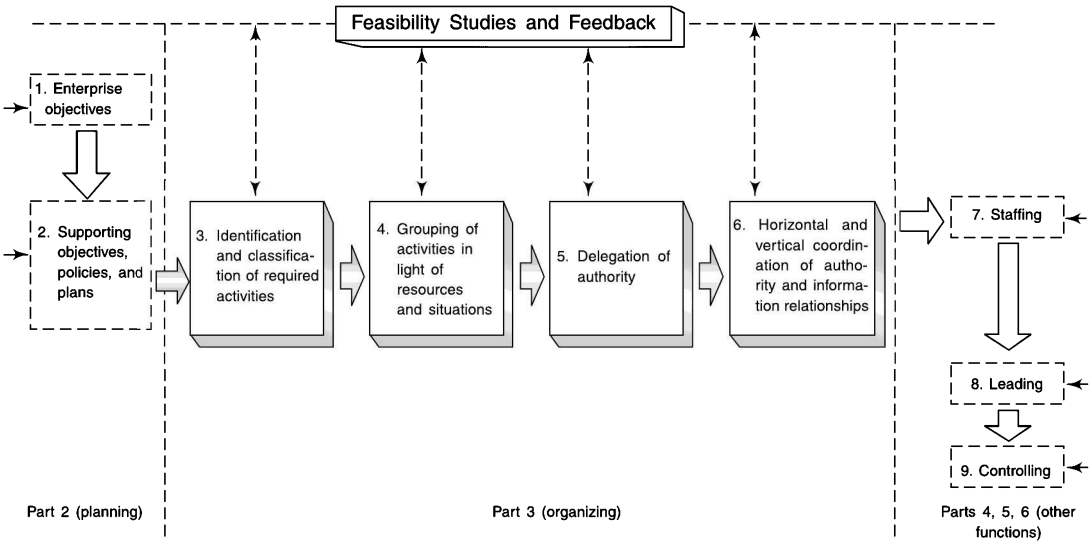
There is a fundamental logic to organizing, as shown in Figure 7.4. The organizing process consists of the following six steps, although steps 1 and 2 are actually part of planning:

1. Establishing enterprise objectives
2. Formulating supporting objectives, policies, and plans
3. Identifying, analyzing, and classifying the activities necessary to accomplish these objectives
4. Grouping these activities in light of the human and material resources available and the best way, under the circumstances, of using them
5. Delegating to the head of each group the authority necessary to perform the activities
6. Tying the groups together horizontally and vertically, through authority relationships and information flows

## Some Misconceptions

Organizing does not imply any extreme occupational specialization, which in many instances makes work uninteresting, tedious, and unduly restrictive. There is nothing in organization itself that dictates this. To say that tasks should be specific is not to say they must be limited and mechanical. In any organization, jobs can be defined to allow little or no personal leeway or, conversely, the widest possible discretion. One must not forget that there is no best way to organize and that the application of structural organization theory must take into account the situation.

**Figure 7.1**
**The Organizing Process.**






## BASIC QUESTIONS FOR EFFECTIVE ORGANIZING

It is useful to analyze the managerial function of organizing by raising and answering the following questions:

- What determines the span of management and hence the levels of organization? (answered in this chapter)
- What determines the basic framework of departmentation, and what are the strengths and weaknesses of the basic forms? (answered in Chapter 8)
- What kinds of authority relationships exist in organizations? (answered in Chapter 9)
- How should authority be dispersed throughout the organization structure, and what determines the extent of this dispersion? (answered in Chapter 9)
- How should the manager make organization theory work in practice? (answered in Chapter 10)

The answers to these questions form a basis for a theory of organizing. When considered along with similar analyses of planning, staffing, leading, and controlling, they constitute an operational approach to management.

## SUMMARY

The term *organization* is often used loosely. Formal organization is the intentional structure of roles. Informal organization is a network of personal and social relations neither established nor required by formal authority but arising spontaneously. The span of management refers to the

number of people a manager can effectively supervise. A wide span of management results in few organizational levels, and a narrow span results in many levels. There is no definite number of people a manager can always effectively supervise; the number depends on several underlying factors. These include the degree of training of subordinates that is required and is possessed, the clarity of authority delegation, the clarity of plans, the use of objective standards, the rate of change, the effectiveness of communication techniques, the amount of personal contact needed, and the level in the organization.

Intrapreneurs and entrepreneurs focus on innovation and creativity. It is the manager's responsibility to create an environment that promotes entrepreneurship.

Reengineering that may require a redesign of business processes has become popular in some companies. The results of these efforts have shown positive but also some negative results.

The steps in organizing include formulating objectives and supporting objectives, policies, and plans to achieve the ends (strictly speaking, this is carried out in planning); identifying and classifying activities; grouping these activities; delegating authority; and coordinating authority as well as information relationships.

## KEY IDEAS AND CONCEPTS FOR REVIEW

- ✔ Organizational role
- ✔ Organizing
- ✔ Formal organization
- ✔ Informal organization
- ✔ Department
- ✔ Principle of the span of management
- ✔ Factors determining the span of management
- ✔ Entrepreneuring and intrapreneuring
- ✔ Innovation and entrepreneurship
- ✔ Reengineering key aspects
- ✔ Logical steps of organizing
- ✔ Basic questions for effective organizing

## FOR DISCUSSION

1. Since the positions in an organization must be occupied by people, and since an effective organization depends on people, it is often said that the best organization arises when a manager hires good people and lets them do their jobs in their own way. Comment.
2. A formal organization is often conceived of as a communication system. Is it? How?
3. Construct a diagram depicting the formal organization of an enterprise or activity with which you are familiar. How does this organization chart help or hinder the establishment of an environment for performance?
4. Using the same enterprise or activity as in question 3, chart its informal organization. Does it help or hinder the formal organization? Why?
5. When you become a manager, what criteria will you favor to determine your span of management?

## EXERCISES/ACTION STEPS

1. Organize a family picnic using the steps suggested in this chapter.
2. Interview a manager in your community and ask him or her how many subordinates he or she has. Are different numbers of subordinates supervised at the top, the middle, and the bottom of the organizational hierarchy? What really determines the span of management in this organization? Do you think the span is appropriate for the enterprise?

## INTERNET RESEARCH

Use a search engine and type "post-it-notes" to find out more about the yellow stickers that have been very profitable for 3M.



**International Case**

## Reengineering the Business Process at Proctor & Gamble[17]

Proctor & Gamble (P&G), a multinational corporation known for products such as diapers, shampoo, soap, and toothpaste, was committed to improving value to the customer. Its products were sold through various channels, such as grocery retailers, wholesalers, mass merchandisers, and club stores. The flow of goods in the retail grocery channel was from the factory's warehouse to the distributors' warehouses before going to the grocery stores where customers selected the merchandise from the shelves.

The improvement-driven company was not satisfied with its performance and developed a variety of programs to improve its service and the efficiency of its operation. One such program was electronic data interchange, which provided daily information from the retail stores to P&G. The installation of the system resulted in better service, reduced inventory levels, and labor-cost savings. Another approach, the continuous replenishment program, which focuses on the flow of products in the supply chain, provided additional benefits for P&G as well as for its retailer customers. Eventually, the entire ordering system was redesigned, with the result of dramatic performance improvements.

The reengineering efforts also required restructuring of the organization. P&G had been known for its brand management for more than 50 years. But in the late 1980s and early 1990s, the brand management approach pioneered by the company in the 1930s required rethinking and restructuring. In a drive to improve efficiency and coordination, several brands were combined with authority and responsibility given to category managers. Such a manager would determine overall pricing and product policies. Moreover, the category managers had the authority to withdraw weak brands, thus avoiding conflict between similar brands. They were also held responsible for the profit of the product category they were managing. The switch to category management required not only new skills but also a new attitude.

**Questions**

1. The reengineering efforts of P&G focused on the business process system. Do you think other processes, such as the human system, or other managerial policies need to be considered in a process redesign?
2. What do you think was the reaction of the brand managers, who may have worked under the old system for many years, when the category management structure was installed?
3. As a consultant, would you have recommended a top-down or a bottom-up approach, or both, to process redesign and organizational change? What are the advantages and disadvantages of each approach?

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# 8 Organization Structure: Departmentation

## CHAPTER OBJECTIVES

After studying this chapter, you should be able to:

- Identify the basic patterns of traditional departmentation and their advantages and disadvantages
- Analyze matrix organizations
- Explain strategic business units
- Examine organization structures for global enterprises
- Understand the virtual and boundaryless organizations
- Recognize that there is no single best pattern of departmentation

The limitation on the number of subordinates that can be directly managed would restrict the size of enterprises if it were not for the device of departmentation. Grouping activities and people into departments makes it possible to expand organizations—at least in theory—to an indefinite degree. Departments, however, differ with respect to the basic patterns used to group activities. The nature of these patterns, developed out of logic and practice, and their relative merits will be dealt with, in the following sections.

At the outset, it must be emphasized that there is no single best form of departmentation that is applicable to all organizations or to all situations. The pattern used will depend on the given situations and on what managers believe will yield the best results for them in the situation they face. The pattern may also be based on the concepts of reengineering, discussed in the previous chapter.

## DEPARTMENTATION BY ENTERPRISE FUNCTION

**Departmentation by enterprise function** Grouping of activities according to the functions of an enterprise, such as production, sales, and financing.

Grouping activities in accordance with the functions of an enterprise—functional departmentation—embodies what enterprises typically do. Because all enterprises undertake the creation of something useful and desired by others, the basic enterprise functions are production (creating utility or adding utility to a product or service), selling (finding customers, patients, clients, students, or members who will agree to accept the product or service at a price or for a cost), and financing (raising and collecting, safeguarding, and expending the funds of the enterprise). It has been

logical to group these activities into such departments as engineering, production, selling or marketing, and finance. Figure 8.1 shows a typical functional grouping for a manufacturing company.

Often these particular functional designations do not appear in the organization chart. First, there is no generally accepted terminology: a manufacturing enterprise employs the terms production, sales, and finance; a wholesaler is concerned with such activities as buying, selling, and finance; and a railroad is involved with operations, traffic, and finance.

A second reason for the variance of terms is that basic activities often differ in importance: hospitals have no sales departments; churches, no production departments. This does not mean that these activities are not undertaken; rather, they are unspecialized or narrower in scope that they are combined with other activities.

A third reason for the absence of sales, production, or finance departments in many organization charts is that other methods of departmentation may have been deliberately selected. Those responsible for the enterprise may decide to organize on the basis of product, customer, territory, or marketing channel (the way goods or services reach the user).



Functional departmentation is the most widely used basis for organizing activities and is present in almost every enterprise at some level in the organization structure. The characteristics of the selling, production, and finance functions of enterprises are so widely recognized and thoroughly understood that they are the basis not only of departmental organization but also, most often, of departmentation at the top level.

Coordination of activities among departments may be achieved through rules and procedures, various aspects of planning (e.g., goals and budgets), the organizational hierarchy, personal contacts, and sometimes liaison departments. Such a department may be used to handle design or change problems between engineering and manufacturing. The advantages and disadvantages of departmentation by enterprise function are listed in Figure 8.1.

## DEPARTMENTATION BY TERRITORY OR GEOGRAPHY

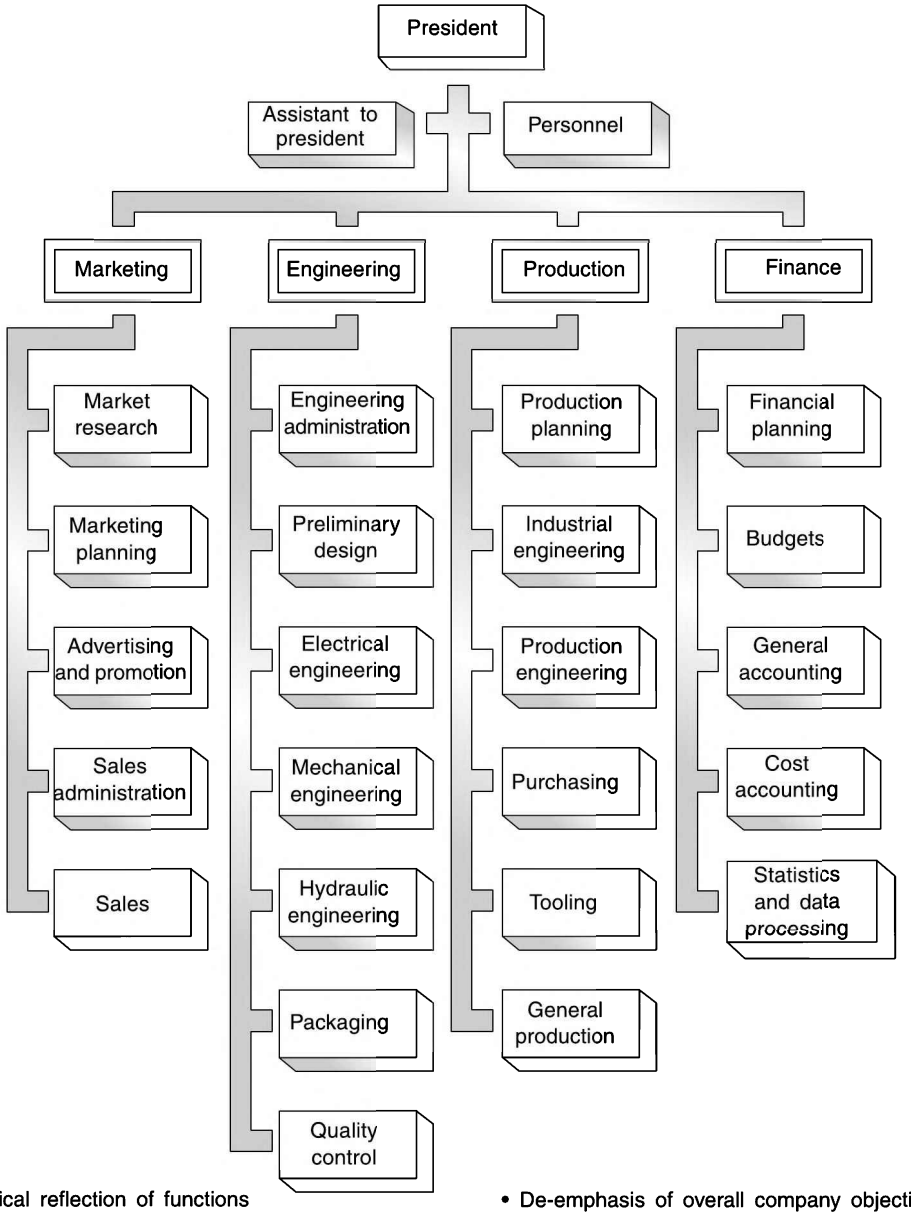
**Departmentation by territory or geography** Grouping of activities by area or territory is common in enterprises operating over wide geographic areas.

Departmentation based on territory is common in enterprises that operate over wide geographic areas. In this case, it may be important that activities in a given area or territory be grouped and assigned to a manager, for example, as shown in Figure 8.2.

Although territorial departmentation is especially attractive to large-scale firms or other enterprises whose activities are physically or geographically dispersed, a plant that is local in its activities may assign the personnel in its security department on a territorial basis, placing two guards at each of the south and west gates, for example. Department stores assign floorwalkers on this basis, and it is a common way to assign janitors, window washers, and the like. Business firms resort to this method when similar operations are undertaken in different geographic areas, as in automobile assembling, chain retailing and wholesaling, and oil refining. Many government agencies—the tax department, the central bank, the courts, and the postal service, among others—adopt this basis of organization in their efforts to provide like services simultaneously across the nation. Territorial departmentation is most often used in sales and in production; it is not used in finance, which is usually concentrated at the headquarters.

**Figure 8.1**

**A Functional Organization Grouping (in a Manufacturing Company).**

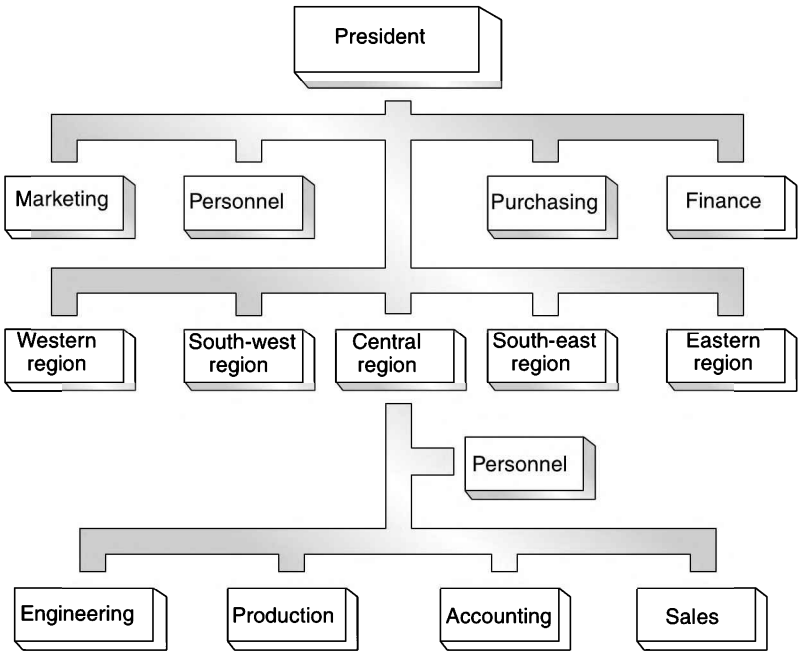



- Logical reflection of functions
- Maintains power and prestige of major functions
- Follows principle of occupational specialization
- Simplifies training
- Furnishes means of tight control at top

- De-emphasis of overall company objectives
- Overspecializes and narrows viewpoints of key personnel
- Reduces coordination between functions
- Responsibility for profits is at the top only
- Slow adaptation to changes in the environment
- Limits development of general managers

**Figure 8.1**

**A Territorial or Geographic Organization Grouping (in a Manufacturing Company).**




**Advantages**

- Places responsibility at a lower level
- Places emphasis on local markets and problems
- Improves coordination in a region
- Takes advantage of economies of local operations
- Better face-to-face communication with local interests
- Furnishes measurable training ground for general managers

**Disadvantages**

- Requires more persons with general manager abilities
- Tends to make maintenance of economical central services difficult and may require services such as personnel or purchasing at the regional level
- Increases problem of top management control

The advantages and disadvantages of departmentation by territory or geography are shown in Figure 8.2.

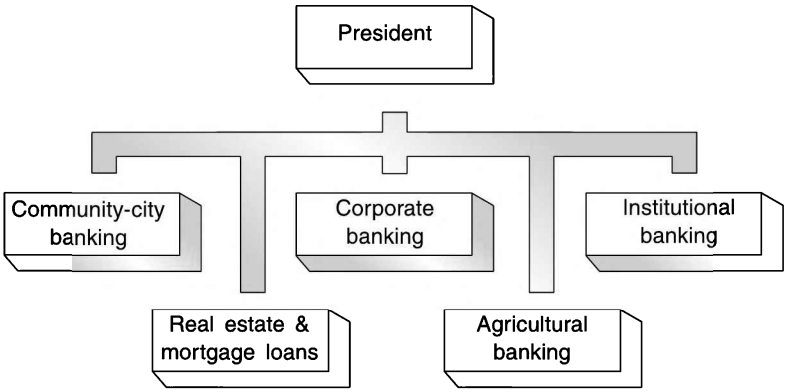
## DEPARTMENTATION BY CUSTOMER GROUP

**Departmentation by customer group** Grouping of activities that reflects a primary interest in customers.

Grouping activities so that they reflect a primary interest in customers is common in a variety of enterprises. Customers are the key to the way activities are grouped when each customer group is managed by one department head. The industrial sales department of a wholesaler that also sells to retailers is a case in point. Business owners and managers frequently arrange activities on this basis to cater to the requirements of clearly defined customer groups.

**Figure 8.1**

**Customer Departmentation (in a large bank).**




**Advantages**

- Encourages concentration on customer needs
- Gives customers feeling that they have an understanding supplier (banker)
- Develops expertness in customer area

**Disadvantages**

- May be difficult to coordinate operations between competing customer demands
- Requires managers and staff expert in customers' problems
- Customer groups may not always be clearly defined (for example, large corporate firms vs. other corporate businesses)

For the structure and the advantages and disadvantages of customer departmentation, see Figure 8.3.

## DEPARTMENTATION BY PRODUCT

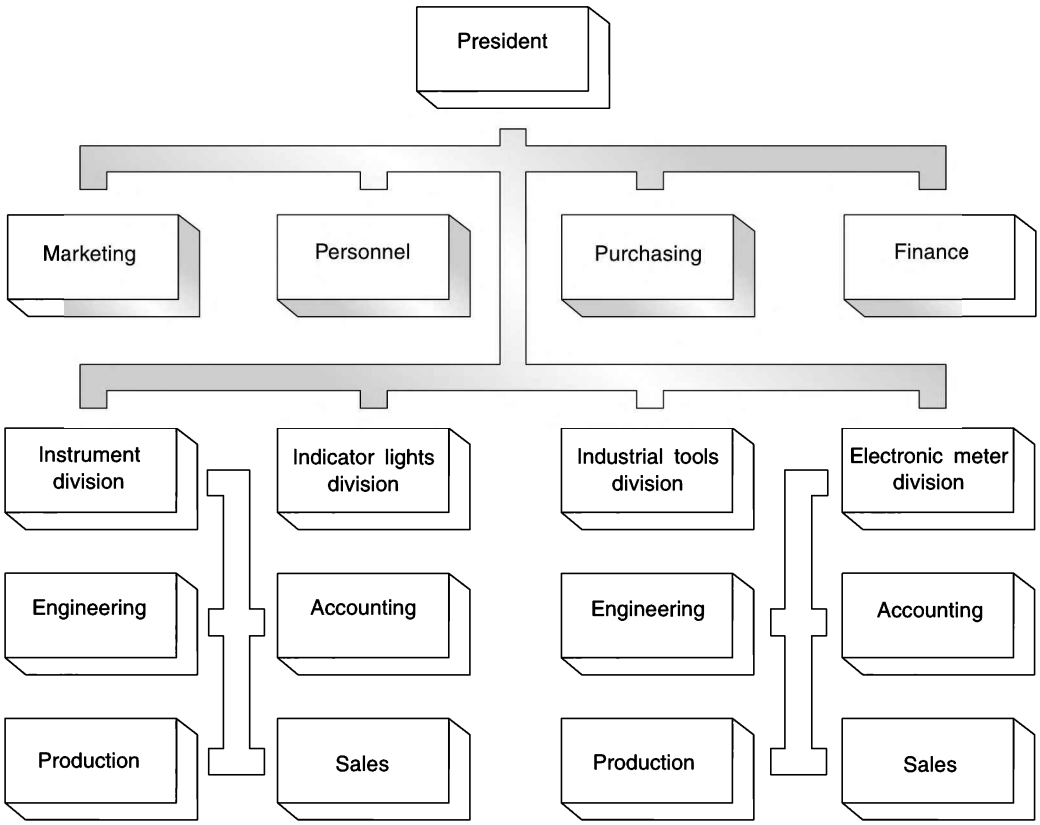
**Departmentation by product** Grouping of activities according to products or product lines, especially in multiline, large enterprises.

Grouping activities on the basis of products or product lines has been growing in importance in multiline, large-scale enterprises. It can be seen as an evolutionary process. Typically, companies and other enterprises adopting this form of departmentation were organized by enterprise functions. With the growth of the firm, production managers, sales and service managers, and engineering executives encountered problems of size. The managerial job became complex, and the span of management limited the managers' ability to increase the number of immediate subordinate managers. At this point, reorganization on the basis of product division became necessary. This structure permits top management to delegate to a division executive extensive authority over the manufacturing, sales, service, and engineering functions that relate to a given product or product line and to exact a considerable degree of profit responsibility from each of these managers. Figure 8.4 show an example of a typical product organization grouping for a manufacturing company,* together with the advantages and disadvantages of such departmentation.

*Product departmentation is also used in nonmanufacturing companies.

**Figure 8.1**

**A Product Organization Grouping (in a Manufacturing Company).**




**Advantages**

- Places attention and effort on product line
- Facilitates use of specialized capital, facilities, skills, and knowledge
- Permits growth and diversity of products and services
- Improves coordination of functional activities
- Places responsibility for profits at the division level
- Furnishes measurable training ground for general managers

**Disadvantages**

- Requires more persons with general manager abilities
- Tends to make maintenance of economical central services difficult
- Presents increased problem of top management control

In considering advantages, it is essential to avoid oversimplification. Product-line managers may be saddled with heavy overhead costs, allocated from the expense of operating the headquarters office, perhaps a central research division, and, frequently, many central service divisions. Product managers understandably resent being charged with costs over which they have no control.

LEADERSHIP PERSPECTIVE

### Organizing the Chrysler Fiat Strategy[1]

Within a span of three years, Chrysler has had three new owners. First, it was Daimler Chrysler, then it was Cerberus Capital Management, and now it is the Italian Fiat car company headed by CEO Sergio Marchionne. His communication to the Chrysler employees is straight forward, telling them that mediocrity will not be tolerated. In addition, he has little tolerance for organizational hierarchy and he tends to emphasize delegation. He sets goals and expects his managers to report about the process of achieving the aims.

Chrysler has been organized into three separate companies: the Dodge, Jeep, and Chrysler lines, each with its own CEOs. Marchionne wants to use Fiat's advantage in small car technologies and Chrysler's strengths in SUVs, pickups, and minivans. Fiat gained a good reputation in small, fuel-efficient cars, which is a weakness of Chrysler. The small car innovation included the development of a Diesel engine, a technology Fiat had to sell to the German Bosch company because Fiat's need for cash. Sergio Marchionne's aim is to use the respective strengths of Fiat and Chrysler and his organization skills to succeed in the very competitive global car market. ■■

## MATRIX ORGANIZATION

**Matrix organization** Combining functional and project or product patterns of departmentation in the same organization structure.

Another kind of departmentation is matrix or grid organization or project or product management. However, pure project management need not imply a grid or matrix. The essence of **matrix organization** normally is the combining of functional and project or product patterns of departmentation in the same organization structure. As shown in Figure 8.5, which depicts the matrix organization in an engineering department, there are functional managers in charge of engineering functions and an overlay of project managers responsible for the end product. While this form is common in engineering and in research and development, it has also been widely used, although seldom drawn as a matrix, in product marketing organization.

This kind of organization occurs frequently in construction (e.g., building a bridge), in aerospace (e.g., designing and launching a weather satellite), in marketing (e.g., an advertising campaign for a major new product), in the installation of an electronic data processing system, or in management consulting firms where management experts work together on a project.

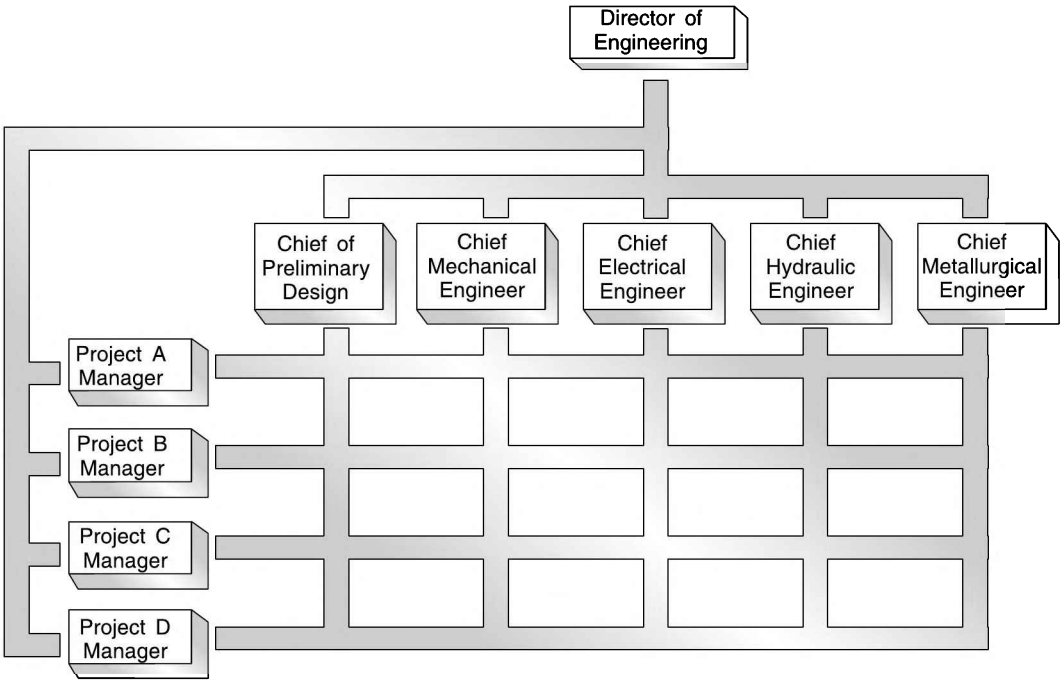
### Guidelines for Making Matrix Management Effective

Matrix management can be made more effective by following these guidelines:

- Define the objectives of the project or task
- Clarify the roles, authority, and responsibilities of managers and team members
- Ensure that influence is based on knowledge and information, rather than on rank

**Figure 8.1**

**Matrix Organization (in Engineering).**




**Advantages**
- Oriented toward end results
- Professional identification is maintained
- Pinpoints product-profit responsibility

**Disadvantages**
- Conflict in organization authority exists
- Possibility of disunity of command exists
- Requires manager effective in human relations



- Balance the power of functional and project managers
- Select an experienced manager for the project who can provide leadership
- Undertake organization and team development
- Install appropriate cost, time, and quality controls that report deviations from standards in a timely manner
- Reward project managers and team members fairly

**Strategic business units** Distinct businesses set up as units in a larger company to ensure that certain products or product lines are promoted and handled as though each were an independent business.

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## STRATEGIC BUSINESS UNITS

Companies have been using an organizational device generally referred to as a **strategic business unit** (SBU). SBUs are distinct businesses set up as units in a larger company to ensure that certain products or product lines are promoted and handled as though each were an independent business. One of the earlier users of this organizational device was General Electric, which wanted to ensure that each product or product line of the hundreds offered by the company would receive the same attention as it would if it were developed, produced, and marketed by an independent company. In some cases, companies have also used the device for

a major product line. Occidental Chemical Company, for example, used it for such products as phosphates, alkalies, and resins.

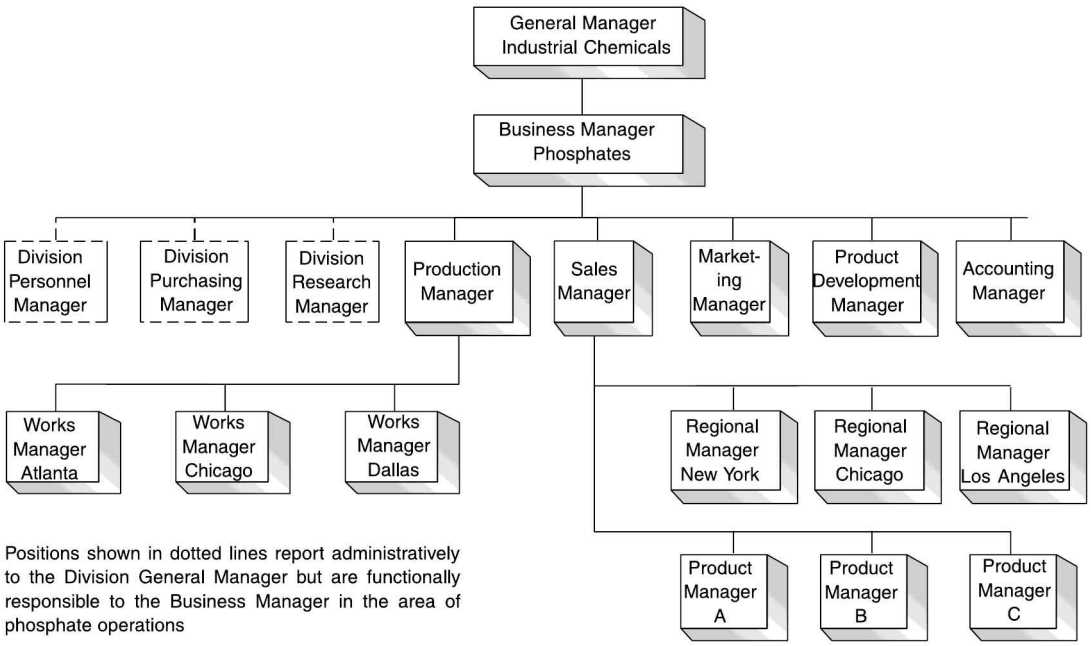
To be called an SBU, generally, a business unit must meet specific criteria. For example, it must have its own mission, distinct from the missions of other SBUs; have definable groups of competitors; prepare its own integrative plans, fairly distinct from those of other SBUs; manage its own resources in key areas; and be of an appropriate size, neither too large nor too small. Obviously, in practice, it might be difficult to establish SBUs that meet all of these criteria.

For each SBU, a manager (usually a business manager) is appointed with the responsibility of guiding and promoting the product from the research laboratory through product engineering, market research, production, packaging, and marketing and with bottom-line responsibility for its profitability. Thus, an SBU is given its own mission and goals as well as a manager who, with the assistance of full-time or part-time staff (people from other departments assigned to the SBU on a part-time basis), will develop and implement strategic and operating plans for the product. The organization of a typical SBU, such as that for phosphates in Occidental Chemical, is shown in Figure 8.6. Note that reporting to the business manager for phosphates are all the functions that would be found necessary in a separate company.

Obviously, the major benefit of utilizing an SBU organization is to provide assurance that a product will not get "lost" among other products (usually those with

**Figure 8.1**

**Typical Strategic Business Unit Organization (in a Large Industrial Chemical Company).**



larger sales and profits) in a large company. It preserves the attention and energies of a manager and staff whose job is to guide and promote a product or product line. It is thus an organizational technique for preserving the entrepreneurial attention and drive so characteristic of the small company. In fact, it is an excellent means of promoting entrepreneurship, which is likely to be lacking in the large company.

### Potential Problems with Strategic Business Units[2]

**Core competency** Collective learning, coordination, and integration of skills to obtain "streams of technology."

C. K. Prahalad and Gary Hamel, two professors in strategic management, suggest that companies should invest in their core competencies and watch out for the tyranny of SBUs. The **core competency** is the organization's collective learning, especially the capability to coordinate the different production skills and the integration of these skills into what they call "streams of technology." For example, for car maker Honda, engines are the core products to which design and development skills are directed that result in end products such as cars and motorcycles. If the motorcycle division had received resources for development, it may not share this technology with a car division. The allocation of resources to individual SBUs can result in the underinvestment in core competencies (such as in engines) that benefit the total organization. Also, SBU managers may not be willing to share talented people and may hide them rather than lend them to another SBU.



## ORGANIZATION STRUCTURES FOR THE GLOBAL ENVIRONMENT

Organization structures differ greatly for enterprises operating in the global environment. The kind of structure depends on a variety of factors, such as the degree of international orientation and commitment. A company may begin internationalizing its operation by simply creating at its headquarters an international department, headed by an export manager. As the company expands its international operation, foreign subsidiaries and later international divisions may be established in various countries, reporting to a manager in charge of global operation at headquarters or possibly the chief executive officer (CEO). With further growth of the international operations, several countries may be grouped into regions, such as Africa, Asia, Europe, and South America. Furthermore, the European division (and other divisions as well) may then be divided into groups of countries, such as the European Union (EU) countries, non-EU countries, and Eastern European countries.

**INTERNATIONAL PERSPECTIVE**

### Organizational Challenges at the TATA Conglomerate[3]

The Tata Group is India's biggest conglomerate with about 100 companies operating in some 40 businesses. How does such a company organize? For one, there is no central strategy at TATA. The company has only a small staff comprised mostly of Tata's sons. Critical for the organization is the Bombay House with a

board of senior executives. One of the task is mentoring managers and to promote the philosophy of the importance of social responsibility. Another important aspect of filling the positions in the organization structure is the Management Center in Pune. Success requires not only a good strategy, but also an effective organization structure as well as effective human resource planning and development. ■■

Companies may also choose other forms of departmentation in addition to the geographic pattern. For example, an oil company may subdivide the functional group for exploration according to regions, such as exploration in Alaska or in the Persian Gulf. Similarly, the functional groups of refining and marketing may be subdivided into the various regions. Clearly, petroleum products may be marketed in areas other than those where exploration or production takes place.

## THE VIRTUAL ORGANIZATION[4]

**Virtual organization** A rather loose concept of a group of independent firms or people that are connected through, usually, information technology.

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The **virtual organization** is a rather loose concept of a group of independent firms or people that are connected through, usually, information technology. These firms may be suppliers, customers, and even competing companies. The aim of the virtual organization is to gain access to another firm's competence, to gain flexibility, to reduce risks, or to respond rapidly to market needs. Virtual organizations coordinate their activities through the market where each party sells its goods and services.

The virtual organization has advantages and disadvantages. When IBM developed the personal computer in 1981, all major components were acquired from other companies. This enabled IBM to market the product in 15 months. The microprocessor was bought from Intel and the software was developed by Microsoft. The "open" architecture was based on well-known standards, and components could be purchased from many vendors. By using outside parties, IBM had to invest little for its decentralized strategy. Later, however, the open architecture strategy revealed its downside. Other firms could purchase microprocessors directly from Intel and the software operating system from Microsoft.

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Virtual organizations may have neither an organization chart nor a centralized office building. The modern library may not be a building with lots of bookshelves. One may never have to visit a library—a database, a computer, a modem, and a password may be all that is necessary to access the library. The Open University in the United Kingdom may be one example of a university without a place. It has a home base with an administrative body but no students. The students are spread all over the world, and so are the professors. They may never meet each other. The technological possibilities are exciting, but how do we manage people we never see? Clearly, many unanswered questions surround the virtual organization.

## THE BOUNDARYLESS ORGANIZATION

www.ge.com

Jack Welch, former CEO of General Electric, stated his vision for the company as a "boundaryless company." By this, he meant an "open, anti-parochial environment, friendly toward the seeking and sharing of new ideas, regardless of their origin."[5]

The purpose of this initiative was to remove barriers between the various departments as well as between domestic and international operations. To reward people for adopting the "integration model," bonuses were awarded to those who not only generated new ideas but also shared them with others.

## CHOOSING THE PATTERN OF DEPARTMENTATION[6]

There is no one best pattern of departmentation that is applicable to all organizations and all situations. Managers must determine what is best by looking at the situation they face: the jobs to be done and the way they should be done, the people involved and their personalities, the technology employed in the department, the users being served, and other internal and external environmental factors in the situation. However, if they know the various departmentation patterns, and the advantages, disadvantages, and dangers of each, practicing managers should be able to design the organization structure most suitable for their particular operations.



### The Aim: Achieving Objectives

Departmentation is not an end in itself but is simply a method of arranging activities to facilitate the accomplishment of objectives. Each method has its advantages and disadvantages. Consequently, the process of selection involves a consideration of the relative advantages of each pattern at each level in the organization structure. In all cases, the central question concerns the type of organizational environment that the manager wishes to design and the situation being faced. The preceding discussion of the alternative methods of departmentation shows that each method yields certain gains and involves certain costs.

**LEADERSHIP PERSPECTIVE**

### Marisa Bellisario Leading Italian ITALTEL[7]

www.italtel.it

When Marisa Bellisario became director and CEO of ITALTEL, a state-owned telecommunication equipment manufacturer in Italy, the company was in trouble; high losses, large debts, insufficient research and development, and an overstaffed, unionized organization. Ms. Bellisario took some major steps to turn the company around and to improve productivity. Here are examples of the new direction:

- Restructuring the organization into business units, which was accomplished through open communication and cooperation with the union
- Leading the company into electronics, which required retraining of employees
- Developing a program to upgrade low-skilled women in the workforce
- Pushing for intra-European cooperation with companies in France, England, and Germany
- Improving efficiency through innovation in products and manufacturing processes

Leadership such as this has to be analyzed in terms of the characteristics of the leader (technical, human, conceptual, and design skills); relations with the followers, especially the unionized workforce; and the situation which demanded a strong leader to deal with the crisis. Changing an organization's structure to achieve enterprise objectives is difficult, but Marisa Bellisario achieved this in a difficult environment. ■■

## Mixing Types of Departmentation

Another point to be highlighted concerns the mixing of types of departmentation within a functional area. For example, a wholesale drug firm has grouped the buying and selling activities relating to beverages in one product department, but it has grouped, on the same level, all other selling activities on a territorial basis. A manufacturer of plastic goods has territorialized both the production and the sale of all its products except dinnerware, which is itself a product department. A functional department manager may, in other words, employ two or more bases for grouping activities on the same organizational level. Such practices may be justified on logical grounds. The objective of departmentation is not to build a rigid structure, balanced in terms of levels and characterized by consistency and identical bases, but to group activities in the manner that will best contribute to achieving enterprise objectives. If a variety of bases does this, there is no reason why managers should not take advantage of the alternatives before them.

# SUMMARY

The grouping of activities and people into departments makes organizational expansion possible. Departmentation can be done by enterprise function, by territory or geography, and by the kinds of customers served. Other kinds of departmentation are the product organization grouping, matrix or grid organization, project organization, and the strategic business unit. The organization structure for the global environment may vary greatly, ranging from having an export department at the headquarters to regional groupings, with many variations in between. In addition, companies may have also one or more functionally organized groupings within a region. The virtual organization is a loose concept of a group of independent companies or people that are connected often through computer technology.

There is no single best way to organize; the most appropriate pattern depends on various factors in a given situation. These factors include the kind of job to be done, the way the task must be done, the kinds of people involved, the technology, the people served, and other internal and external considerations. At any rate, the selection of a specific departmentation pattern should be done so that organizational and individual objectives can be achieved effectively and efficiently. Accomplishing this goal often requires mixing forms of departmentation.

## KEY IDEAS AND CONCEPTS FOR REVIEW

- ✔ Departmentation by enterprise function
- ✔ Departmentation by territory or geography
- ✔ Departmentation by customer group
- ✔ Departmentation by product
- ✔ Matrix organization (or grid, or project, or product)
- ✔ Strategic business unit
- ✔ Organization structures for global enterprises
- ✔ Virtual organization
- ✔ Boundaryless organization

## FOR DISCUSSION



1. Some sociologists tell us that organization structuring is a social invention. What do you think they mean? Do they imply that there is a "right" or "wrong" way to organize? What would you suggest as a test of whether an organization structure is "right"?
2. If you were the president of a company that was organized along functional lines and a consultant suggested that you organize along territorial or product lines, what might concern you in following this recommendation?
3. Why do most large department store and supermarket chains organize their stores on a territorial basis and the internal store units by products? Give examples from your own experience.
4. Why do most small companies use functionally organized departments?
5. Why are so many national government agencies organized primarily on a territorial basis?
6. Do you see any reasons why managing by objectives may result in increased use of matrix organization structures?
7. How does this chapter illustrate a situational approach to management?

## EXERCISES/ACTION STEPS

1. Divide the class into groups of four or five students (depending on class size). Assign one pattern of departmentation to each group (assign two to each if the class is small). The groups should discuss (a) the nature of the assigned departmentation, (b) companies that use this departmental arrangement, and (c) the advantages and disadvantages of this form of departmentation.
2. Select a company and identify the departmentation pattern (or patterns) it uses. Draw an organization chart for the firm. Why do you think the company selected the type of departmentation it did? Would you recommend it?

## INTERNET RESEARCH

1. Search the Internet for the term "matrix organization" to find examples of the grid. Also note the difficulties those companies may have encountered.
2. Search the Internet for the term "strategic business units." Look for the ways that various organizations are utilizing such units to enhance their management.

**International Case**

## GM: General Motors, Generous Motors, Government Motors[8]

On June 1, 2009, the once-powerful General Motors (GM) with a distinguished history, applied for protection from its creditors by declaring bankruptcy. Up to 2008, GM was the largest car company in the world.

Under the leadership of Alfred Sloan, the long-time president (1923) and chairman (1937), General Motors established the concept of the modern organization with brand names such as Chevrolet, Pontiac, Oldsmobile, Buick, and Cadillac with a price structure ranging from the lowest to the highest. While Ford Motor Company focused on low-priced, mass-produced cars (Model T), GM produced cars for "every purse and purpose" according to the needs of its diverse customers.

Problems began during the oil crisis in the early 1970s. GM did not respond well to the customers' demand for fuel-efficient cars which Japanese and German car makers offered. Rather than responding to the environmental changes, GM focused on producing profitable pickups and fuel-inefficient SUVs.

GM, called by some as "Generous Motors" agreed to generously pay the benefit packages demanded by the United Auto Workers (UAW), a powerful union. The high health and pension costs eventually added about $1,400 to the cost of their cars. In contrast, Japanese car makers in America were not burdened by similar costs which, in turn, allowed them to price their cars competitively. In addition, foreign auto firms had a reputation for producing reliable cars. Young people were especially attracted by the car offerings of Toyota, Honda, Mercedes, and BMW cars. Many of those cars were produced outside the Detroit car capital at lower costs.

This downward slide resulted in the 2009 bankruptcy with the U.S. government owning 60.8% in stock of the company, the Canadian government receiving 11.7%, the UAW trust 17.5% and bondholders 10%. With the high percentage of government ownership, some now call GM "Government Motors." After the government bailout of billions of dollars, the influence of the government has been clearly felt with the former CEO, Rick Wagoner, being ousted and being replaced by Fritz Henderson.

With the GM fall, will it mean the demise of GM and the car industry, in general? Certainly most car companies suffered greatly in 2009. GM may have to close some 14 factories and 2,400 dealers. This may also mean a loss of 29,000 hourly and white-collar jobs, but with the worldwide recession receding, the demand for cars, especially in emerging countries, will increase. GM does quite well in China and in Brazil. It is expected that the GM market share will stabilize and the US government pressure will push the company to produce more fuel-efficient cars.

**Questions**

1. What should GM do after the bankruptcy?
2. What are the governmental demands by the Obama administration?
3. If GM can produce a competitively priced car (less in price than comparable cars), would you buy one? Why or why not?

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# 9 Line/Staff Authority, Empowerment, and Decentralization

## CHAPTER OBJECTIVES

After studying this chapter, you should be able to:

- Understand the nature of authority, power, and empowerment
- Distinguish between line, staff, and functional authority
- Discuss the nature of decentralization, centralization, and delegation of authority
- Recognize the importance of obtaining balance in the centralization and decentralization of authority

Now that the patterns of departmentation have been discussed, it is time to consider another essential question: What kind of authority is found in an organization structure? The question has to do with the nature of authority relationships—the problem of line and staff. This chapter will also deal with the question of how much authority should be delegated. The answer concerns the decentralization of authority. Without authority—the power to exercise discretion in making decisions—properly placed in managers, departments cannot become smoothly working units harmonized for the accomplishment of enterprise objectives. Authority relationships, whether vertical or horizontal, are the factors that make organization possible, facilitate departmental activities, and bring coordination to an enterprise.

**Power** The ability of individuals or groups to induce or influence the beliefs or actions of other persons or groups.

**Authority** The right in a position to exercise discretion in making decisions affecting others.

## AUTHORITY AND POWER

Before concentrating on the authority in organization, it will be useful to distinguish between authority and power. **Power**, a much broader concept than authority, is the ability of individuals or groups to induce or influence the beliefs or actions of other persons or groups.[1] **Authority** in organization is the right in a position (and, through it, the right of the person occupying the position) to exercise discretion in making decisions affecting others. It is of course one type of power, but power in an organizational setting.

Although there are many different **bases of power**, the power of primary concern in this book is *legitimate power*.[2] It normally arises from position and derives from

our cultural system of rights, obligations, and duties whereby a "position" is accepted by people as being "legitimate." In a privately owned business, authority of position arises primarily from the social institution (a "bundle of rights") of private property. In government, this authority arises basically from the institution of representative government. A traffic officer who gives you a traffic ticket has the power to do so because we have a system of representative government in which we have elected legislators to make laws and provide for their enforcement.

Power may also come from the *expertness* of a person or a group. This is the power of knowledge. Physicians, lawyers, and university professors may have considerable influence on others because they are respected for their specialized knowledge. Power may further exist as *referent power*, that is, influence that people or groups may exercise because people believe in them and their ideas. Thus, Martin Luther King had very little legitimate power but, by the force of his personality, his ideas, and his ability to preach, was able to strongly influence the behavior of many people. Likewise, a movie star or a military hero might possess considerable referent power.

In addition, power arises from the ability of some people to grant rewards. Purchasing agents, with little position power, might be able to exercise considerable influence through their ability to expedite or delay a much-needed spare part. Likewise, university professors have considerable *reward power*: they can grant or withhold high grades. *Coercive power* is still another type. Closely related to reward power and normally arising from legitimate power, it is the power to punish, whether by firing a subordinate or by withholding a merit pay increase.

While organizational authority is the power to exercise discretion in decision-making, it almost invariably arises from the power of position, or legitimate power. When people speak of authority in managerial settings, they are usually referring to the power of position. At the same time, other factors, such as personality and style of dealing with people, are also involved in leadership.



## EMPOWERMENT

**Empowerment** Employees at all levels in the organization are given the power to make decisions without asking their superiors for permission.

In recent years, it has become fashionable to advocate a variety of empowerment approaches. **Empowerment** means that employees, managers, or teams at all levels in the organization are given the power to make decisions without asking their superiors for permission. The notion underlying empowerment is that those closest to the task are best able to make the decision—provided that they have the required competencies. Actually, the notion of empowerment is historically based on suggestion schemes, job enrichment, and worker participation.[3] Moreover, concepts of delegation discussed later in this chapter are also closely related to empowerment.

Both delegation and empowerment are a matter of degree.[4] They also require that employees and teams accept responsibility for their actions and tasks. Conceptually, this can be illustrated as follows:

- Power should be equal to responsibility (P = R).
- If power is greater than responsibility (P > R), then this could result in autocratic behavior of the superior who is not held accountable for his or her actions.

- If responsibility is greater than power (R > P), then this could result in frustration because the person has not the necessary power to carry out the task for which he or she is responsible.

The increasing interest in empowerment is due in part to the rise in global competitiveness, the need to respond quickly to the demands and expectations of customers, and a better-educated workforce that demands greater autonomy. Empowerment of subordinates means that superiors have to share their authority and power with their subordinates. Thus, an autocratic leadership style, when used as the only way to manage, is often inappropriate for the 21st century organization. Most employees want to be involved and want to participate in decisions; this participation creates a sense of belonging and achievement and raises self-esteem.

Effective management requires that empowerment be sincere, based on mutual trust, accompanied by relevant information for the employees to carry out their tasks, and given to competent people.[5] Moreover, employees should be rewarded for exercising their decision authority.

**LEADERSHIP PERSPECTIVE**

### Empowerment at the Ritz-Carlton Hotel under the Leadership of Horst Schulze[6]

www.ritzcarlton.com

Customers are important—and so are employees. At the Ritz-Carlton Hotel, not only customers but also employees are treated with dignity and respect, as illustrated by the company's slogan "Ladies and gentlemen serving ladies and gentlemen." The president, Horst Schulze, empowers employees by authorizing the front-desk staff to spend up to $2,000 to serve customers and to ensure the satisfaction of their guests. Sales managers' authority is even higher: $5,000. Employees are encouraged to propose recommendations for quality improvement. The aim is to obtain twice as many suggestions from employees as the number of complaints from customers. Treating both employees and customers with respect has helped earn Ritz-Carlton the prestigious Malcolm Baldrige National Quality Award. ■■

**Scalar principle** The clearer the line of authority, the clearer will be the responsibility for decision-making and the more effective will be organizational communication.

## LINE/STAFF CONCEPTS AND FUNCTIONAL AUTHORITY

Line authority gives a superior a line of authority over a subordinate. It exists in all organizations as an uninterrupted scale or series of steps. Hence, the **scalar principle** in organization: the clearer the line of authority from the ultimate management position in an enterprise to every subordinate position, the clearer will be the responsibility for decision-making and the more effective will be organizational communication. In many large enterprises, the steps are long and complicated; but even in the smallest; the very fact of organization introduces the scalar principle.

**Line authority** The relationship in which a superior exercises direct supervision over a subordinate.

**Staff relationship** is advisory.

It therefore becomes apparent from the scalar principle that **line authority** is that relationship in which a superior exercises direct supervision over a subordinate—an authority relationship in a direct line or steps.

The nature of **staff relationship** is advisory. The function of people in a pure staff capacity is to investigate, research, and give advice to line managers.

**INTERNATIONAL PERSPECTIVE**

## Line or Staff? What is your Career Goal?

The goal of many MBA graduates is to work in staff positions, using their analytical skills to advise line managers. It has been reported that in 1985 over a third of Harvard's MBA graduates chose such a career.[7] In earlier years, this percentage was even higher.

In the 1980s, partly owing to the slow economy and competitive pressure, the situation was changing as many large companies reduced their staff strength. For example, the task of strategy formulation was carried out more frequently by line managers, who also had to implement the strategy, rather than by strategic planners in headquarters. Consequently, people who used to plan, advise, and analyze business situations moved into line positions in which they were required to set priorities, make decisions, and motivate people to contribute to the aims of the enterprise.

While some staff personnel made an effective transition into line positions, others failed. One of the problems these "newcomers" encountered was the resentment of the "old-time" managers, who saw the positions they had aspired to, taken by former staff. Clearly, line work is different from staff tasks. Having real authority for executing decisions can be exciting, but not everyone can make the transition. Thus, aspiring managers should carefully analyze their strengths, weaknesses, and motivations before choosing their career paths. ■■



**Functional authority** The right delegated to an individual or a department to control specified processes, practices, policies, or other matters relating to activities undertaken by persons in other departments.

**Functional authority** is the right delegated to an individual or a department to control specified processes, practices, policies, or other matters relating to activities undertaken by persons in other departments. One can better understand functional authority by thinking of it as a small slice of the authority of a line superior. If the principle of unity of command were followed without exception, authority over these activities would be exercised only by the relevant line superiors. But numerous reasons—including a lack of specialized knowledge, a lack of ability to supervise specified processes, and the danger of diverse interpretations of policies—explain why these managers are occasionally not allowed to exercise this authority. In such cases, line managers are deprived of some authority, which is delegated by their common superior to a staff specialist or to a manager in another department. For example, a company controller is ordinarily given functional authority to prescribe the system of accounting throughout the company, but this specialized authority is really a delegation from the chief executive.

# DECENTRALIZATION OF AUTHORITY

The previous section focused on the kinds of authority relationships, such as line, staff, and functional authority. This section emphasizes the dispersion of authority in the organization.

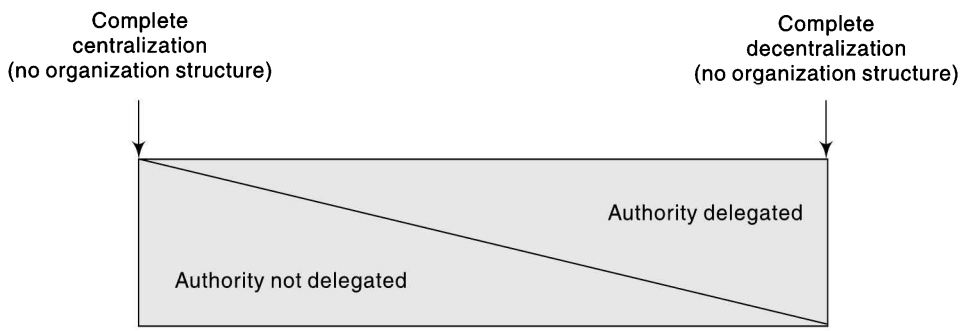
## The Nature of Decentralization

**Decentralization** The tendency to disperse decision-making authority in an organized structure.

Organizational authority is merely the discretion conferred on people to use their judgment to make decisions and issue instructions. **Decentralization** is the tendency to disperse decision-making authority in an organized structure. It is a fundamental aspect of delegation, to the extent that authority that is delegated is decentralized. How much should authority be concentrated in or dispersed throughout the organization? There could be absolute centralization of authority in one person, but that implies no subordinate managers and therefore no structured organization. Some decentralization exists in all organizations. On the other hand, there cannot be absolute decentralization; for, if managers delegated all their authority, their status as managers would cease, their position would be eliminated, and there would, again, be no organization. Centralization and decentralization are tendencies, as indicated in Figure 9.1.

**Figure 9.1**

**Centralization and Decentralization as Tendencies.**




## Different Kinds of Centralization

The term *centralization* has several meanings:

- *Centralization of performance* pertains to geographic concentration; it characterizes, for example, a company operating in a single location.
- *Departmental centralization* refers to concentration of specialized activities, generally in one department. For example, maintenance for a whole plant may be carried out by a single department.
- *Centralization of management* is the tendency to restrict delegation of decision-making. A high degree of authority is held by managers at or near the top of the organizational hierarchy.

### Decentralization as a Philosophy and Policy

Decentralization implies more than delegation: It reflects a philosophy of organization and management. It requires careful selection of which decisions to push down the organization structure and which to hold near the top, specific policy-making to guide the decision-making, proper selection and training of people, and adequate controls. A policy of decentralization affects all areas of management and can be looked upon as an essential element of a managerial system. In fact, without it, managers could not use their discretion to handle the ever-changing situations they face.

## DELEGATION OF AUTHORITY

Authority is delegated when a superior gives a subordinate discretion to make decisions. Clearly, superiors cannot delegate authority they do not have, whether they are board members, presidents, vice presidents, or supervisors.

The **process of delegation** involves (1) determining the results expected from a position, (2) assigning tasks to the position, (3) delegating authority for accomplishing these tasks, and (4) holding the person in that position responsible for the accomplishment of the tasks. In practice, it is impossible to split this process, since expecting a person to accomplish goals without giving him or her authority to achieve them is impractical, as is delegating authority without knowing the end results to which it will be applied. Moreover, since the superior's responsibility cannot be delegated, a boss must hold subordinates responsible for completing their assignments.



## THE ART OF DELEGATION

Most failures in effective delegation occur not because managers do not understand the nature and principles of delegation but because they are unable or unwilling to apply them. Delegation is, in a way, an elementary act of managing. Yet studies almost invariably find that poor or inept delegation is one of the causes of managerial failures. Much of the reason lies in personal attitudes toward delegation.

### Personal Attitudes toward Delegation

Although charting an organization and outlining managerial goals and duties will help in making delegation decisions, and knowledge of the principles of delegation will furnish a basis for it, certain personal attitudes underlie real delegation.

**Receptiveness** An underlying attribute of managers who will delegate authority is a willingness to give other people's ideas a chance. Decision-making always involves some discretion, and a subordinate's decision is not likely to be exactly the one a superior would have made. The manager who knows how to delegate must have a minimum of the "NIH (not invented here) factor" and must not only be able to welcome the ideas of others but also help others come up with ideas and compliment them on their ingenuity.

**Willingness to let go**[8] A manager who will effectively delegate authority must be willing to release the right to make decisions to subordinates. A major fault of some managers who move up the executive ladder—or of the pioneer who has built a large business from the small beginning of, say, a garage machine shop—is that they want to continue making decisions for the positions they have left. Corporate presidents and vice presidents who insist on confirming every purchase or approving the appointment of every laborer or secretary do not realize that doing so takes their time and attention away from far more important decisions.

If the size or complexity of the organization forces delegation of authority, managers should realize that there is a "law of comparative managerial advantage," somewhat like the law of comparative economic advantage that applies to nations. Well known to economists and logically sound, the law of comparative economic advantage states that a country's wealth will be enhanced if it exports what it produces most efficiently and imports what it produces least efficiently, even though it could produce the imported goods more cheaply than any other nation. Likewise, managers will enhance their contributions to the firm if they concentrate on tasks that contribute most to the firm's goals and assign to subordinates other tasks, even though they could accomplish them better themselves.

**Willingness to allow mistakes by subordinates** Although no responsible manager would sit idly by and let a subordinate make a mistake that might endanger the company or the subordinate's position in the company, continual checking on the subordinate to ensure that no mistakes are ever made will make true delegation impossible. Since everyone makes mistakes, a subordinate must be allowed to make some, and their cost must be considered an investment in personal development.

Serious or repeated mistakes can be largely avoided without nullifying delegation or hindering the development of a subordinate. Patient counseling, asking leading or discerning questions, and carefully explaining the objectives and policies are some of the methods available to the manager who would delegate well. None of these techniques involve discouraging subordinates with intimidating criticism or harping on their shortcomings.

**Willingness to trust subordinates** Superiors have no alternative to trusting their subordinates, for delegation implies a trustful attitude between them. This trust is sometimes hard to come by. A superior may put off delegation with the thought that subordinates are not yet experienced enough, that they cannot handle people, that they have not yet developed judgment, or that they do not appreciate all the facts bearing on a situation. Sometimes these considerations are true, but then a superior should either train subordinates or else select others who are prepared to assume the responsibility. Too often, however, bosses distrust their subordinates because they do not wish to let go, are threatened by subordinates' successes, do not delegate wisely, or do not know how to set up controls to ensure proper use of the authority.

**Willingness to establish and use broad controls** Since superiors cannot delegate responsibility for performance, they should not delegate authority

unless they are willing to find means of getting feedback, that is, of assuring themselves that the authority is being used to support enterprise or departmental goals and plans. Obviously, controls cannot be established and exercised unless goals, policies, and plans are used as basic standards for judging the activities of subordinates. More often than not, reluctance to delegate and to trust subordinates comes from the superior's inadequate planning and understandable fear of loss of control.

## Overcoming Weak Delegation

The following practical guide will facilitate successful delegation:

- *Define assignments and delegate authority in light of results expected*. Or, to put it another way, grant sufficient authority to make possible the accomplishment of goal assignments.
- *Select the person in light of the job to be done*. Although the good organizer will approach delegation primarily from the standpoint of the task to be accomplished, in the final analysis staffing as a part of the total system of delegation cannot be ignored.
- *Maintain open lines of communication*. Since the superior does not delegate all authority or abdicate responsibility, and therefore managerial independence does not exist, decentralization should not lead to insulation. There should be free flow of information between superior and subordinate, furnishing the subordinate with the information needed to make decisions and to interpret properly the authority delegated. Delegation, then, does depend on situations.
- *Establish proper controls*. Because no manager can relinquish responsibility, delegation should be accompanied by techniques for ensuring that the authority is properly used. But if controls are to enhance delegation, they must be relatively broad and be designed to show deviations from plans, rather than interfering with routine actions of subordinates.
- *Reward effective delegation and successful assumption of authority*. Managers should be ever-watchful for means of rewarding both effective delegation and effective assumption of authority. Although many of these rewards will be monetary, the granting of greater discretion and prestige—both in a given position and by promotion to a higher position—is often even more of an incentive.



**Recentralization** Centralization of authority that was once decentralized; normally not a complete reversal of decentralization, as the authority delegated is not wholly withdrawn.

## RECENTRALIZATION OF AUTHORITY[9] AND BALANCE AS THE KEY TO DECENTRALIZATION

At times, an enterprise can be said to recentralize authority—to centralize authority that was once decentralized. **Recentralization** is normally not a complete reversal of decentralization, as the authority delegation is not wholly withdrawn by the managers who made it. The process is a centralization of authority over a certain type of activity or function, wherever in the organization it may be found. To avoid pitfalls, any program for decentralization of authority must take into consideration the advantages and limitations shown in Table 9.1.

**Table 9.1** Advantages and Limitations of Decentralization

| *Advantages* |
|---|
| 1. Relieves top management of some burden of decision-making and forces upper-level managers to let go. |
| 2. Encourages decision-making and assumption of authority and responsibility. |
| 3. Gives managers more freedom and independence in decision-making. |
| 4. Promotes establishment and use of broad controls that may increase motivation. |
| 5. Makes comparison of performance of different organizational units possible. |
| 6. Facilitates setting up of profit centers. |
| 7. Facilitates product diversification. |
| 8. Promotes development of general managers. |
| 9. Aids in adaptation to fast-changing environment. |
| *Limitations* |
| 1. Makes it more difficult to have a uniform policy. |
| 2. Increases complexity of coordination of decentralized organizational units. |
| 3. May result in loss of some control by upper-level managers. |
| 4. May be limited by inadequate control techniques. |
| 5. May be constrained by inadequate planning and control systems. |
| 6. Can be limited by the lack of qualified managers. |
| 7. Involves considerable expenses for training managers. |
| 8. May be limited by external forces (national labor unions, governmental controls, tax policies). |
| 9. May not be favored by economies of scale of some operations. |

## SUMMARY

There are a number of different bases of power. Power can be legitimate, expert, referent, reward, or coercive. Empowerment enables people to make decisions without asking their superiors for permission. Line authority is that relationship in which a superior exercises direct supervision over subordinates. The staff relationship, on the other hand, consists of giving advice and counsel. Functional authority is the right to control selected processes, practices, policies, or other matters in departments other than a person's own. It is a small slice of a line manager's authority and should be used sparingly.

Another important concept is decentralization, which is the tendency to disperse decision-making authority. Centralization, on the other hand, is the concentration of authority. It may refer to geographic concentration, departmental centralization, or the tendency to restrict delegation of decision-making. The process of delegation of authority includes determining the results to be achieved, assigning tasks, delegating authority for accomplishing the tasks, and holding people responsible for results.

Failures in effective delegation are often due to personal attitudes. Weak delegation can be overcome by considering the tasks and the goals, maintaining open communication, establishing proper controls, and motivating through appropriate rewards. Previously decentralized authority may be recentralized. Balance is the key to proper decentralization.

## KEY IDEAS AND CONCEPTS FOR REVIEW

- ✔ Power
- ✔ Authority
- ✔ Bases of power
- ✔ Empowerment
- ✔ Scalar principle
- ✔ Line
- ✔ Staff
- ✔ Functional authority
- ✔ Decentralization
- ✔ Three kinds of centralization
- ✔ Process of delegation
- ✔ Attitudes toward delegation
- ✔ Recentralization
- ✔ Advantages and limitations of decentralization



## FOR DISCUSSION

1. What are the kinds of power exercised in your organization or school?
2. Take as examples a number of positions in any kind of enterprise (business, church, government, etc.). Classify each as line or staff.
3. How many cases of functional authority in organization have you seen? Analyzing a few, do you agree that they could have been avoided? If avoidance had been possible, would you have eliminated them? If they could not have been avoided or if you had not wanted to eliminate them, how would you remove most of the difficulties that might arise?
4. If you were asked to advise a young college graduate who has accepted a staff position as assistant to a factory manager, what suggestions would you make?
5. Why is poor delegation of authority often found to be the most important cause of managerial failure?
6. In many countries, companies often have grown from within and are family-owned. In these companies, very little authority is decentralized. What do you think would explain this tendency? What effect does it have?
7. If you were a manager, would you decentralize authority? State several reasons for your answer. How would you make sure that you did not decentralize too much?
8. Should authority be pushed down in an organization as far as it will go? Why or why not?

## EXERCISES/ACTION STEPS

1. Interview a line manager and a staff person at a local company. Ask them what they like and dislike about their jobs. Reflect on the interviews and ask yourself whether a line or a staff position is the major aim of your career plan.

2. Interview two line managers about their views on delegation. Do they think that their superiors delegate sufficient authority to them? Also inquire how they feel about delegating authority to their subordinates.

## INTERNET RESEARCH

1. Search the Internet for the term "employee empowerment" and read what others think about the empowerment theory. Also find out what "disempowerment" and "dysempowerment" are.
2. Search the Internet using the key words "scalar principle." Find out the details of the principle.

## International Case — How the Lexus Was Born—and Continued Its Success in the United States, but will Lexus Succeed in Japan?[10]

One of the best examples of global competition is in the car industry. As the Japanese gained market share in America, U.S. car makers required the Japanese to self-impose quotas on cars exported to the United States. This encouraged Japanese firms not only to establish their plants in the United States but also to build bigger and more luxurious cars to compete against the higher-priced U.S. cars and the expensive European cars such as the Mercedes and the BMW.

One such Japanese car is the Lexus, by Toyota. This car is aimed at customers who would like to buy a Mercedes or BMW but cannot afford either. With a sticker price of $35,000, the Lexus is substantially less expensive than comparable European imports.

In 1983, Toyota set out to develop the best car in the world—measured against the Mercedes and the BMW. The aim was to produce a quiet, comfortable, and safe car that could travel at 150 miles per hour and still avoid the gas guzzler tax imposed on cars getting less than 22.5 miles per gallon. This seemed to be an idea of conflicting goals: cars being fast seemed irreconcilable with cars being at the same time fuel-efficient. To meet these conflicting goals, each subsystem of the car had to be carefully scrutinized, improved whenever possible, and integrated with the total design. The first version of the 32-valve V-8 engine did not meet the fuel economy requirement. The engineers applied a problem-solving technique called "thoroughgoing countermeasures at the source." This means an attempt to improve every component until the design objectives are achieved. Not only the engine but also the transmission and other parts underwent close scrutiny to make the car meet U.S. fuel requirements.

Toyota's approach to achieving quality is different from that of German car manufacturers. The latter use relatively labor-intensive production processes. In contrast, Toyota's advanced manufacturing technology aims at high quality through automation requiring only a fraction of the workforce used by German car makers. Indeed, this strategy, if successful, may be the secret weapon to gain market share in the luxury car market.

In the development of the Lexus, each aspect of the car was carefully studied with the consumer in mind. The car body and the rear, for example, were meticulously designed and tested

for air drag. The cars of competitors serving as benchmarks were thoroughly studied. Similarities of the Lexus with the Mercedes and BMW are unmistakable. The name Lexus, by the way, was carefully chosen. Several potential names consisting of nonsense words were selected by the computer. Lexus, it was thought, conveys a sense of luxury.

To market the car, Toyota established a separate dealer network, an approach taken previously by Honda to sell its Acura cars. Again, painstaking effort was applied in designing the showrooms and in training mechanics. For the introduction of the car, reporters were flown to Germany, where they had the opportunity to compare the Lexus with Jaguar, BMW, and Mercedes cars on the *autobahn*, which has no speed limit. After six years in the making, the $500 million car was finally born. What will the future hold for the Lexus?

European car makers are naturally concerned about the coming invasion of Japanese luxury cars. Mercedes and BMW not only have to compete in the U.S. market but also may face threats of a Japanese invasion on the Continent as the European Union moves toward a global automobile market.

Since its birth in the 1980s, Lexus has grown into a formidable competitor in the United States. Lexus cars are known for their quality, reliability, and smooth ride. Originally, the ES 250 model was based on the less expensive Toyota Camry, a fact that competitors used in their advertising. By 2002, however, the company offered an array of models, such as the five-passenger cars LS 430 (starting at $54,800 in the United States), ES 300, GS 430, and IS 300. These cars are supplemented by the LX 470, which is an eight-passenger sport utility vehicle, and the five-passenger RX 300. Critics think of some Lexus cars as being comfortable but boxy luxury vehicles. But this image does not apply to the Lexus SC 430, which is a hardtop convertible with an automatically retractable roof. Clearly, the model lineup may have overshadowed General Motors' Cadillac line, which was held in high esteem in the past. On the other hand, German brands such as Mercedes-Benz, BMW, and Audi as well as the Japanese Infiniti compete for the same markets as Lexus does.



Toyota's Lexus has been a successful luxury car in the U.S.—but not in Japan so far. Japanese luxury car buyers have been favoring German cars made by BMW, Mercedes, and Audi (made by Volkswagen). With Toyota's popularity in Japan, there was little need to introduce the luxury Lexus. Now, however, Toyota realizes the opportunity to sell their luxury model, the Lexus, to sell to young professionals with money. But it may not be easy because they appreciate the German engineering.

Cars that have been sold similar to U.S. Lexus models have been sold in Japan with the Toyota label. It might be a tricky task for Japanese dealers to sell similar cars with the Lexus name plate. To prepare the introduction of the Lexus models in Japan (the LS 430 is planned for 2006), Toyota trains its dealers in what has been called the "Lexus College" for comparing its cars with the German brands. If Toyota is successful, Japan's Nissan and Honda may follow with the introduction of their luxury brands Infinity and Accord, both available in America, but not in Japan.

**Questions**

1. Could U.S. manufacturers apply the same approach as Toyota to build such a car? Why or why not? What might be some obstacles?
2. Do you think that the Lexus can obtain an image similar to that of the BMW and Mercedes cars?
3. Prepare a profile of the potential buyer of the Lexus.

4. What should Mercedes and BMW do to counteract the Japanese threat in the United States and Europe?
5. Why has the Lexus model been very successful in the U.S. but has not been marketed in Japan? (Suggestion: Review the frequency of repair records of luxury cars. Also talk to Lexus dealers or Lexus owners).
6. Do you think Lexus will succeed in Japan? Why or why not?

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# MAJOR PRINCIPLES OR GUIDES FOR THE MANAGERIAL FUNCTION OF ORGANIZING

As mentioned in the Part Closing on planning, a complete set of empirically proven, interrelated principles has not been discovered and codified; experience and observation of managing indicate certain fundamental managerial principles or guides.

Each principle is given a number with a letter that represents the type of managerial function. Therefore, the letter "O" refers to organizing.

## Major Principles or Guides for Organizing

Although the science of organizing has not yet developed to the point where its principles are infallible laws, there is considerable agreement among management scholars and practitioners about a number of them. These principles are truths (or are believed to be truths) of general applicability, although their application is not precise enough to give them the exactness of the laws of pure science. They are more in the nature of essential criteria for effective organizing. The most essential guiding principles of organizing are summarized as follows:

## The Purpose of Organizing

The purpose of organizing is to aid in making objectives meaningful and to contribute to organizational efficiency.

| | | |
|---|---|---|
| O1. | *Principle of unity of objectives* | An organization structure is effective if it enables individuals to contribute to enterprise objectives. |
| O2. | *Principle of organizational efficiency* | An organization is efficient if it is structured to aid the accomplishment of enterprise objectives with a minimum of unsought consequences or costs. |

## The Reason for Organizing

The basic reason for organization structure is the limitation of the span of management. If there were no such limitation, an enterprise might have only one manager and no organization structure.

| | | |
|---|---|---|
| O3. | *Principle of the span of management* | In each managerial position, there is a limit to the number of persons an individual can effectively manage, but the exact number will depend on the impact of underlying variables. |

## The Structure of Organization: Authority

Authority is the cement of an organization structure, the thread that makes it possible, and the means by which groups of activities can be placed under a manager and coordination of organizational units can be promoted. It is the tool by which a manager is able to exercise discretion and create an environment for individual performance. Some of the most useful principles of organizing are related to authority.

| | | |
|---|---|---|
| O4. | *Scalar principle* | The clearer the line of authority from the ultimate management position in an enterprise to every subordinate position, clearer will be the responsibility for decision-making and more effective will be organizational communication. |
| O5. | *Principle of delegation by results expected* | Authority delegated to all individual managers should be adequate to ensure their ability to accomplish expected results. |
| O6. | *Principle of absoluteness of responsibility* | The responsibility of subordinates to their superiors for performance is absolute, and superiors cannot escape responsibility for the organizational activities of their subordinates. |
| O7. | *Principle of parity of authority and responsibility* | The responsibility for actions should neither be greater than that implied by the authority delegated, nor should it be less. |
| O8. | *Principle of unity of command* | The more complete an individual's reporting relationships to a single superior, the smaller the problem of conflicting instructions and the greater the feeling of personal responsibility for results. |
| O9. | *Authority-level principle* | Maintenance of intended delegation requires that decision within the authority of individual managers should be made by them and not be referred upward in the organization structure. |



## The Structure of Organization: Departmentalized Activities

Organization involves the design of a departmental framework. Although there are several principles in this area, one is of major importance.

| | | |
|---|---|---|
| O10. | *Principle of functional definition* | The more a position or a department has a clear definition of the results expected, activities to be undertaken, and organizational authority delegated, as well as an understanding of authority and informational relationships with other positions, more adequately the individual responsible can contribute toward accomplishing enterprise objectives. |

## The Process of Organizing

The various principles of authority delegation and of departmentation are fundamental truths about the process of organizing. They deal with phases of the two primary aspects of organizing: authority and activity groupings. There are other principles that deal with the process of organizing. It is through their application that managers gain a sense of proportion or a measure of the total organizing process.

| | | |
|---|---|---|
| O11. | *Principle of balance* | In every structure, there is a need for balance. The application of principles or techniques must be balanced to ensure overall effectiveness of the structure in meeting enterprise objectives. |
| O12. | *Principle of flexibility* | The more the provisions that are made for building flexibility into an organization structure, more adequately an organization structure can fulfill its purpose. |
| O13. | *Principle of leadership facilitation* | The more an organization structure and its delegation of authority enable managers to design and maintain an environment for performance, more they will help the leadership abilities of those managers. |

The principle of balance is common to all areas of science and to all functions of the manager. The inefficiencies of broad spans of management must be balanced against the inefficiencies of long lines of communication. The losses from multiple commands must be balanced against the gains from expertness and uniformity in delegating functional authority to staff and service departments. The savings of functional specialization in departmentalizing must be balanced against the advantages of establishing profit-responsible, semi-independent product or territorial departments. It is apparent, once again, that the application of management theory depends on each specific situation.

The principle of flexibility demands that devices and techniques for anticipating and leading to change be built into every structure. Every enterprise moves toward its goal in a changing environment, both internal and external. The enterprise that develops inflexibilities, whether these are resistance to change, overcomplicated procedures, or too-firm departmental lines, is risking the inability to meet the challenges of economic, technological, biological, political, and social changes.

Since managership depends to a great extent on the quality of leadership of those in managerial positions, it follows from the principle of leadership facilitation that the organization structure should do its part in creating a situation in which a manager can most effectively lead. In this sense, organizing is a technique of promoting leadership. If the authority allocation and the structural arrangements create a situation in which heads of departments tend to be looked upon as leaders and in which their task of leadership is aided, organization structuring has accomplished an essential task.

# 10 Effective Organizing and Organization Culture

## CHAPTER OBJECTIVES

After studying this chapter, you should be able to:

- Avoid mistakes in organizing by planning
- Show how organizing can be improved by maintaining flexibility and by making staff more effective
- Avoid conflict by clarifying the organization structure and ensuring an understanding of organizing
- Promote and develop an appropriate organization culture

In organizing, there is no one best way; it depends on the specific situation.

Organizing involves developing an intentional structure of roles for effective performance. It requires a network of decision and communication centers for coordinating efforts toward group and enterprise goals. To work, an organization structure must be understood, and principles must be put into practice. As emphasized earlier, in organizing, as elsewhere in managing, there is no one best way. What works will always depend on the specific situation.

## AVOIDING MISTAKES IN ORGANIZING BY PLANNING

Establishment of objectives and orderly planning are necessary for good organization.

As with the other functions of managing, establishment of objectives and orderly planning are necessary for good organization. As Lyndall Urwick said in his classic book *The Elements of Administration*, "Lack of design [in organization] is illogical, cruel, wasteful, and inefficient."[1]

### Planning for the Ideal

The search for an ideal organization to reflect enterprise goals under given circumstances is the impetus to planning. The search entails charting the main lines of organization, considering the organizational philosophy of the enterprise managers (e.g., whether authority should be centralized as much as possible or whether enterprise operations should be divided into semi-independent product or territorial divisions), and sketching out consequent authority relationships. The ultimate form established, like all other plans, seldom remains unchanged, and continual

remolding of the ideal plan is normally necessary. Nevertheless, an ideal organization plan constitutes a standard; and by comparing the present structure with it, enterprise leaders know what changes should be made when possible.

An organizer must always be careful not to be blinded by popular notions in organizing because what may work in one enterprise may not work in another. Principles of organizing have general application, but the background of each enterprise's operation and needs must be considered in applying these principles. Organization structure needs to be tailor-made.

### Modification for the Human Factor

If the available personnel do not fit into the ideal structure and cannot or should not be pushed aside, the only choice is to modify the structure to fit individual capabilities, attitudes, or limitations. Although this modification may seem like organizing around people, in this case one is first organizing around the goals to be met and activities to be undertaken and only then making modifications for the human factor. Thus, planning will reduce compromising the necessity for principal whenever changes occur in personnel.



### Advantages of Organization Planning

Planning the organization structure helps determine future personnel needs and required training programs.

Planning the organization structure helps determine future personnel needs and required training programs. Unless it knows what managerial personnel will be needed and what experience should be demanded, an enterprise cannot intelligently recruit people and train them.

Furthermore, organization planning can disclose weaknesses. Duplication of effort, unclear lines of authority, overlong lines of communication, excessive red tape, and obsolete practices show up best when desirable and actual organization structures are compared.

## AVOIDING ORGANIZATIONAL INFLEXIBILITY

One basic advantage of organization planning is the avoidance of organizational inflexibility. Many enterprises, especially those that have been in operation for many years, become too rigid to meet the first test of effective organization structure: the ability to adapt to a changing environment and meet new contingencies. This resistance to change can cause considerable loss of efficiency in organizations.

Some older companies provide ample evidence of inflexibility: an organization pattern that is no longer suited to the times, a district or regional organization that could be either abolished or enlarged because of improved communication, or a structure that is too highly centralized for an enlarged enterprise requiring decentralization.

### Avoiding Inflexibility through Reorganization

Although reorganization is intended to respond to changes in the enterprise environment, there may be other compelling reasons for reorganization. Those related to the

business environment include changes in operation caused by the acquisition or sale of major properties, changes in product line or marketing methods, business cycles, competitive influences, new production techniques, labor union policy, government regulatory and fiscal policies, and the current state of knowledge about organizing. New techniques and principles may become applicable, such as developing managers by allowing them to manage decentralized semi-independent units of a company. Or new methods may come into use, such as gaining adequate financial control with a high degree of decentralization.

Moreover, a new chief executive officer (CEO) and new vice presidents and department heads are likely to have some definite organizational ideas of their own. Shifts may be due merely to the desire of new managers to make changes based on ideas formulated through their previous experience or to the fact that their methods of managing and their personalities require a changed organization structure.

Furthermore, reorganization may be caused by demonstrated deficiencies in an existing structure. Some of these arise from organizational weaknesses: excessive spans of management, an excessive number of committees, lack of uniform policy, slow decision-making, failure to accomplish objectives, inability to meet schedules, excessive costs, or a breakdown of financial control. Other deficiencies may stem from inadequacies of managers. Failure due to lack of knowledge or skill of a manager who for some reason cannot be replaced may be avoided by organizing in a way that moves much of the authority for decision-making to another position.

Personality clashes between managers also may be solved by reorganization. Staff–line conflict may develop to such an extent that it can be resolved only by reorganization.

### The Need for Readjustment and Change

In addition to pressing reasons for reorganization, there is a certain need for moderate and continuing readjustment merely to keep the structure from becoming stagnant. "Empire building" (i.e., building up a large organization so that the manager appears to be more important) is not so attractive when those involved know that their positions are subject to change. As a company president told his subordinates, "Don't bother to build any empires because I can assure you that you won't be in the same position three years from now." Some managers, realizing that an organization structure must be a living thing, make structural changes merely to accustom subordinates to change.

## MAKING STAFF WORK EFFECTIVE

The line–staff problem is not only one of the most difficult that organizations face but also the source of an extraordinarily large amount of inefficiency. Solving this problem requires great managerial skill, careful attention to principles, and patient teaching of personnel.

## Understanding Authority Relationships

Managers must understand the nature of authority relationships if they want to solve the problems between line and staff. As long as managers regard line and staff as groups of people or groupings of activities, confusion will result. Line and staff are authority relationships, and many jobs have elements of both. The line relationship involves making decisions and acting on them. The staff relationship, on the other hand, implies the right to assist and counsel. In short, the line may "tell," but the staff must "sell" (its recommendations).

## Making Line Listen to Staff

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Line managers should be encouraged or required to consult with staff. Enterprises would do well to adopt the practice of compulsory staff assistance where line must listen to staff. At General Motors, for example, product division managers would consult with the headquarters staff divisions before proposing a major program or policy to the top executive or the finance committee. They may not be required to do so, but they are likely to find that this practice results in smoother sailing for their proposals; and if they can present a united front with the staff division concerned, there will unquestionably be a better chance for the adoption of their proposals.



## Keeping Staff Informed

Common criticisms of staff are that specialists operate in a vacuum, fail to appreciate the complexity of the line manager's job, and overlook important facts in making recommendations. To some extent, these criticisms are warranted because specialists cannot be expected to know all the fine points of a manager's job. Specialists should take care that their recommendations deal only with matters within their competence, and operating managers should not lean too heavily on a recommendation if it deals only with part of a problem.

Many criticisms arise because the staff is not kept informed on matters within their field. Even the best staff cannot advise properly in such situations. If line managers fail to inform their staff of decisions affecting their work or if they do not pave the way—through announcements and requests for cooperation—for staff to obtain the requisite information on specific problems, the staff cannot function as intended. In relieving their superiors of the necessity for gathering and analyzing such information, a staff largely justifies their existence.

## Requiring Complete Staff Work

Staff often overlooks the fact that in order to be most helpful, their recommendations should be complete enough to enable a line manager to make a simple positive or negative answer. Staff should be problem solvers and not problem creators. They create problems for managers when their advice is indecisive or vague, when their conclusions are wrong, when they have not taken into account all the facts or have not consulted the persons seriously affected by a proposed solution, or when

they do not point out to superiors the pitfalls as well as the advantages of a recommended course of action.

Complete staff work implies presentation of a clear recommendation based on full consideration of a problem, clearance with persons who will be greatly affected, suggestions about avoiding any difficulties involved, and, often, preparation of the paperwork—letters, directives, job descriptions, and specifications—so that a manager can accept or reject the proposal without further study, long conferences, or unnecessary work. Should a recommendation be accepted, thorough staff work provides line managers with the machinery to put it into effect. People in staff positions who have acquired these capabilities can find themselves highly valued and appreciated.

### Making Staff Work as a Way of Organizational Life

An understanding of staff authority lays the foundation for an organizational way of life. Wherever staff is involved, their responsibility is to develop and maintain a climate of favorable personal relations. Essentially, the task of staff is to make the responsible line managers "look good" and to help them do a better job. A staff person should not attempt to assume credit for an idea. Not only is this a sure way of alienating line teammates who do not like being shown up by a staff person, but operating managers who accept ideas actually bear responsibility for the implementation of the proposals.

Companies also employ the assistance of professional firms, such as consultants to provide advice to line managers. The relationships between line and outside staff are similar to those discussed above. However, outside assistance is often only for a limited time, and it is even more difficult to hold outside staff accountable, especially when they are not involved in the implementation of their recommendations.

## AVOIDING CONFLICT BY CLARIFICATION

A major reason for conflict in organizations is that people do not understand their assignments and those of their coworkers. No matter how well conceived an organization structure may be, people must understand it to make it work. Understanding is aided materially by the proper use of organization charts, accurate job descriptions, spelling out of authority and informational relationships, and introduction of specific goals for specific positions.

### Organization Charts

An **organization chart** indicates how departments are tied together along the principal lines of authority.

Every organization structure, even a poor one, can be charted, for a chart merely indicates how departments are tied together along the principal lines of authority. It is, therefore, somewhat surprising to find top managers occasionally taking pride in the fact that they do not have an organization chart or, if they do have one, feeling that the chart should be kept a secret.

**Advantages of organization charts** A prominent manufacturer once said that, although he could see some use for an organization chart for his factory, he had refused to chart the organization above the level of factory superintendent. His argument was that charts tend to make people overly conscious of being superiors or inferiors, destroy team feeling, and give persons occupying boxes on the chart too great a feeling of "ownership." Another top executive once said that an organization can be changed more easily if it is left uncharted and that the absence of a chart also encourages a competitive drive for higher executive positions by the uncharted middle management group.

These reasons for not charting organization structures are clearly unsound. Subordinate–superior relationships exist not because of charting but, rather, because of essential reporting relationships. As for a chart's creating a too-comfortable feeling and causing a lack of drive in those who have "arrived," these are matters of top leadership—of reorganizing whenever the enterprise environment demands, of developing a tradition of change, and of making subordinate managers continue to meet adequate and well-understood standards of performance. Managers who believe that team spirit can be produced without clearly spelling out relationships are fooling themselves and preparing the way for politics, intrigue, frustration, buck-passing, lack of coordination, duplicated effort, vague policy, uncertain decision-making, and other evidence of organizational inefficiency.



Since a chart maps lines of decision-making authority, sometimes merely charting an organization can show inconsistencies and complexities and thus lead to their correction. A chart also reveals to managers and new personnel how they tie into the entire structure.

An **organization chart** shows formal authority relationships and omits the many significant informal and informational relationships.

**Limitations of organization charts** Organization charts are subject to important limitations. A chart shows only formal authority relationships and omits the many significant informal and informational relationships. Figure 10.1 shows many, but not nearly all, of the informal and informational relationships found in a typical organized enterprise. It shows also the major line, or formal, relationships. It does not show how much authority exists at any point in the structure. While it would be interesting to chart an organization with lines of different widths to denote formal authority of varying degrees, authority is not subject to such measurement. And if the multiple lines of informal relationships and of communication were drawn, they would so complicate a chart that it could not be understood.

Many charts show structures as they are supposed to be or used to be, rather than as they really are. Managers hesitate or neglect to redraft charts, forgetting that organization structures are dynamic and that charts should not be allowed to become obsolete.

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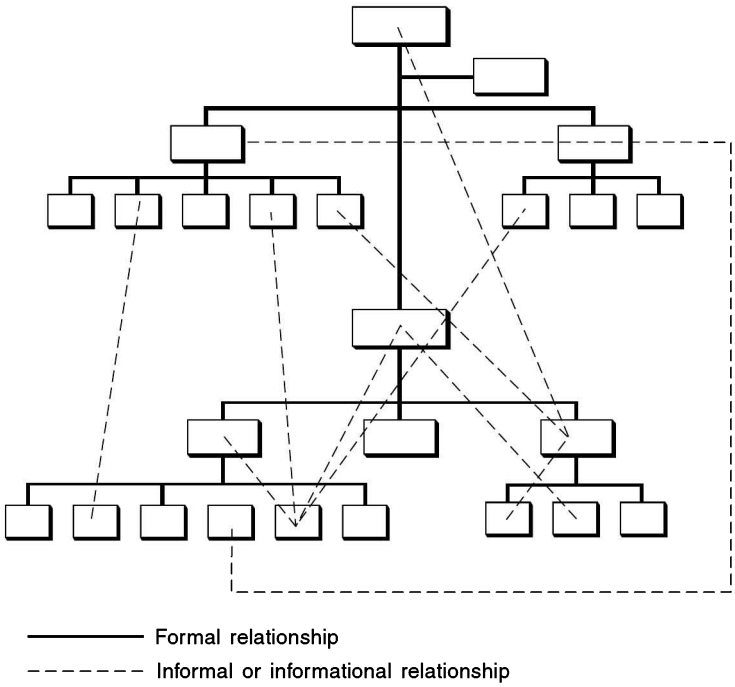
Another difficulty with organization charts is that individuals may confuse authority relationships with status. The staff officer reporting to the corporation's president may be shown at the top of the organization chart, while a regional line officer may be shown one or two levels lower. Although good charting attempts to make levels on the chart conform to levels of enterprise importance, it cannot always do so. This problem can be handled by clearly spelling out authority relationships and by using that best indicator of status—salary and bonus levels. No one is likely, for example,

**Figure 10.1**

**Formal and Informal or Informational Organizations.**




to hear that the general manager of Chevrolet in General Motors feels a sense of inferiority because his position on the chart is below that of the company secretary.

## Position Descriptions

A good **position description** informs every one of the incumbent's responsibilities.

Every managerial position should be defined. A good position description informs everyone of the incumbent's responsibilities. A modern position description is not a detailed list of all the activities an individual is expected to undertake, and it certainly does not specify how to undertake them. Rather, it states the basic function of the position, the major end-result areas for which the manager is responsible, and the reporting relationships involved. The description also clarifies the position's authority, and it states the set of verifiable objectives for the end-result areas.

Position descriptions have many benefits. As jobs are analyzed, duties and responsibilities are brought into focus and areas of overlapping or neglected duties come to light. Forcing people to consider what should be done and who should do it is more than worth the effort. Further benefits of job descriptions include the guidance they provide in training new managers, in drawing up candidate requirements, and in setting salary levels. Finally, as a means of control over organization, the position description furnishes a standard against which to judge whether a position is necessary and, if so, what its organizational level and exact location in the structure should be.

## ENSURING UNDERSTANDING OF ORGANIZING

All the members of an enterprise must understand the structure of their organization in order for that structure to work. This requires teaching. Also, since formal organization is supplemented by informal organization, members of an enterprise must understand the general workings of informal as well as formal organization.

### Teaching the Nature of Organizing

Many soundly conceived organization plans fail because organization members do not understand them. A well-written organization manual—containing a statement of organizational philosophy, programs, charts, and an outline of job descriptions—goes far toward making organizing understandable. If an organization structure is put into written words and charts, it has a better chance of being clear than if it is not. However, even the best-written words and charts do not always clearly convey the same meaning to every reader, so effective managers cannot stop with written clarification. They must teach those in their operation the meaning of the organization structure, their position in it, and the relationships involved. Managers may do this by individual coaching, through staff or special meetings, or by simply watching how the structure works.



### Recognizing the Importance of Informal Organization and the Grapevine

Another way of making the formal organization work effectively is to recognize and take full advantage of informal organization. The nature of informal organization and its distinction from formal organization was discussed in Chapter 7. Many informal organizations arise from the formal organization in which they operate. They include interrelationships that are not usually charted, such as the unwritten rules of organizational conduct, the way to "learn the ropes," the people in an enterprise who have power not implied by or coming from an organizational position, and gossip. One of the best-known examples of informal organization, one which seems to exist in every department and organization is the "grapevine."

**The grapevine** Informal organization tends to exist when members of a formal organization (perhaps a company department) know one another well enough to pass on information—sometimes only gossip—that is in some way connected with the enterprise. In the typical enterprise—whose members spend many hours a day deriving material security and status, as well as social satisfaction, from the grapevine—the desire for information concerning the organization and its people is strong enough for such information to be rapidly transmitted between persons who know and trust one another.

The grapevine, of course, thrives on information not openly available to the entire group, whether because that information is regarded as confidential, or because formal lines of communication are inadequate to spread it, or because it is of the kind, like much gossip, that would never be formally disclosed. Even managers who

conscientiously inform employees through company bulletins or newspapers never so completely or quickly disclose all information of interest as to make the grapevine purposeless.

Since all forms of informal organization serve essential human communication needs, the grapevine is inevitable and valuable. Indeed, an intelligent top manager would probably be wise to feed it accurate information, since it is very effective for quick communication. There is much to be said for a manager's getting a place—personally or through a trusted staff member or secretary—on the company grapevine.

**Benefits of the informal organization** Informal organization brings a kind of cohesiveness to formal organization. It imparts to members of a formal organization a sense of belonging, status, self-respect, and satisfaction. Many managers, understanding this fact, consciously use informal organizations as channels of communication and molders of employee morale.

## PROMOTING AN APPROPRIATE ORGANIZATION CULTURE[2]

The effectiveness of an organization is influenced by the organization culture.

The effectiveness of an organization is also influenced by the organization culture, which affects the way the managerial functions of planning, organizing, staffing, leading, and controlling are carried out. Illustrations of organization culture are given in Table 10.1. Given the choice, most people would probably prefer to work in an

**Table 10.1** Illustrations of Organization Culture and Management Practice

| *Environment A* | *Environment B* |
|---|---|
| **Planning** | |
| Goals are set in an autocratic manner. | Goals are set with a great deal of participation. |
| Decision-making is centralized. | Decision-making is decentralized. |
| **Organizing** | |
| Authority is centralized. | Authority is decentralized. |
| Authority is narrowly defined. | Authority is broadly defined. |
| **Staffing** | |
| People are selected on the basis of friendship. | People are selected on the basis of performance criteria. |
| Training is in a narrowly defined specialty. | Training is in many functional areas. |
| **Leading** | |
| Managers exercise directive leadership. | Managers practice participative leadership. |
| Communication flow is primarily top-down. | Communication flow is top-down, bottom-up, horizontal, and diagonal. |
| **Controlling** | |
| Superiors exercise strict control. | Individuals exercise a great deal of self-control. |
| Focus is on financial criteria. | Focus is on multiple criteria. |

organization with an environment such as B, in which one can participate in the decision-making process, one is evaluated on the basis of performance criteria rather than on the basis of friendship, one has open communication channels in all directions, and one has the opportunity to exercise a great deal of self-control. In their search for excellent companies, Thomas Peters and Robert Waterman, the authors of a best-selling book on management, found that the dominance of a coherent culture characterized these organizations.[3]

But the recognition of the importance of corporate culture is not new at all (although some management gurus want you to believe it is). Over 2,000 years ago, in 431 B.C., Pericles in ancient Greece eloquently urged the Athenians, who were at war with the Spartans, to adhere to values such as those inherent in democracy: informality in communication, the importance of individual dignity, and promotion based on performance. Pericles realized that the underlying values might mean victory or defeat. These values are not so different from those espoused by many U.S. companies.



LEADERSHIP PERSPECTIVE

### How to Create a Value- and Ethics-based Organization Culture[4]

www.saraide.com

Hatim Tyabji was the founding chairman and CEO of VeriFone, Inc., from 1986 to 1998 when he established Saraide, a highly respected company in the telecommunication industry. At the national meeting of the Academy of Management in Toronto in 2000, Mr. Tyabji shared his experience in creating an organization based on ethical values. On one occasion, it was brought to his attention that a manager with excellent performance figures was engaged in malfeasance. Revealing this information would have a very negative effect on the company's share price. Instead of hiding this information until the next quarterly reporting, Mr. Tyabji, after checking carefully the facts, approached the manager who was in charge of a foreign operation, and fired him on the spot. Impressed by this decision, the associates worked especially hard so that the quarterly projection could still be achieved. What message did Mr. Tyabji's decision communicate to the employees of the company? This is a company with a culture in which performance, no matter how impressive, cannot be achieved by unethical behavior. ■■

## Defining Organization Culture

**Organization culture** The general pattern of behavior, shared beliefs, and values that organization members have in common.

As it relates to organizations, **culture** is the general pattern of behavior, shared beliefs, and values that members have in common.[5] Culture can be inferred from what people say, do, and think within an organizational setting. It involves the learning and transmitting of knowledge, beliefs, and patterns of behavior over a period of time, which means that an organization culture is fairly stable and does not change fast. It often sets the tone for the company and establishes implied rules for the

way people should behave. Many company slogans give a general idea of what a particular company stands for. Here are some examples: For General Electric, it is "Progress is our most important product." AT&T is proud of its "universal service." Du Pont makes "better things for better living through chemistry." Delta Airlines describes its internal climate as "the Delta family feeling." KLM Royal Dutch Airlines wants to be known as "the reliable airline." Its president, Jan F. A. de Soet, stated that KLM is not a flamboyant airline; instead, the organization culture reflects the Dutch dislike of ostentation.

www.ge.com
www.att.com
www.dupont.com
www.delta.com
www.klm.com

Similarly, IBM wants to be known for its service, Sears for quality and price, Caterpillar for its 24-hour parts service, and so on. Indeed, the orientation of these companies, often expressed in slogans, contributed to the successful conduct of their businesses.

www.ibm.com
www.sears.com
www.caterpillar.com

Asea Brown & Boveri (a giant electrical company), which comprises a Swedish and a Swiss firm, is guided by a culture illustrated by the phrase "think globally, act locally."[6] The organization culture of the highly decentralized company with more than 200,000 employees around the world is integrated with the culture of the country in which the division operates. On the other hand, its managers act globally with respect to sourcing. For example, depending on the prevailing financial market conditions, goods and services are acquired in the country where it is most favorable to do so.

www.abb.com

**LEADERSHIP PERSPECTIVE**

## Creating an Ethical Culture at Acer in Taiwan and around the World[7]

www.acer.com

Acer Inc. ranks among the world's top personal computer (PC) vendors, offering a wide variety of PC products. By the turn of the century, the Acer Group had some 230 enterprises, employing some 35,000 people in more than 40 countries. Very successful until 1999, the company encountered difficulties in the year 2000 because of external and internal circumstances. Externally, growth of the PC market stagnated, and internally the company experienced problems often associated with growth.

The company structure consisted of two parts: the original equipment manufacturing (OEM) operation, which produced computers for companies such as IBM and Dell Computers, and the Acer brand operation, which focused on its own brand. The OEM unit was more profitable, with a steady demand from the major computer manufacturers. Conflict between the two units led to a new organization structure that divided them. Still, the company was guided by a common philosophy. Specifically, Acer's corporate culture is based on four basic beliefs:[8] (1) human nature is basically good; (2) the customer is number one; (3) putting knowledge to work for the company; (4) being pragmatic and accountable.

The belief in the goodness of human nature is based on Chinese philosophy. It is also congruent with McGregor's assumptions of human nature, a topic that will be

discussed later in the book when the focus is on leading. The customer orientation is similar to that in vogue in the United States since the 1990s. The application of knowledge is critical in the new knowledge economy. Being pragmatic, the fourth point in Acer's beliefs means a common sense approach to managing in which individuals are held responsible for their own actions.

The challenge for Acer is to develop strategies that can effectively adapt to the changing environment and the fallen demand for PC products. At the same time, the organization, anchored in its basic philosophy, must create a flexible organization that can change with the dynamic environment. ■■

## The Influence of the Leader on Organization Culture

**Value** A fairly permanent belief about what is appropriate and what is not that guides the actions and behavior of employees in fulfilling the organization's aims.

Managers, especially top managers, create the climate for the enterprise. Their values influence the direction of the enterprise. Although the term *value* is used differently, a **value** can be defined as a fairly permanent belief about what is appropriate and what is not that guides the actions and behavior of employees in fulfilling the organization's aims. Values can be thought of as forming an ideology that permeates everyday decisions.



In many successful companies, value-driven corporate leaders serve as role models, set the standards for performance, motivate employees, make the company special, and are a symbol to the external environment. It was Edwin Land, the founder of Polaroid, who created a favorable organizational environment for research and innovation. It was Jim Treybig of Tandem, in the Silicon Valley near San Francisco, who emphasized that every person is a human being and deserves to be treated accordingly. It was William Cooper Proctor of Proctor & Gamble who ran the company with the slogan "Do what is right." It was Theodore Vail of AT&T who addressed the needs of customers by emphasizing service. It was Du Pont's CEO Woolard who initiated the "Adopt a Customer" program, through which workers are encouraged to visit their customers monthly to find out their needs and concerns. The organization culture created by corporate leaders can result in managerial functions being carried out in quite different ways.

www.polaroid.com

www.pg.com

While the CEO must indicate the direction, some contend that change must come from the bottom of the organization. At Du Pont's Towanda plant in Pennsylvania, people are organized in self-directing teams. Employees have a great deal of freedom to set their own schedules, solve their own problems, and even participate in selecting coworkers. Indicative of this culture is that managers are called facilitators rather than superiors.

www.sharp-world.com

Changing a culture may take a long time, even five to ten years. It demands changing values, symbols, myths, and behavior. It may require, first, understanding the old culture, then identifying a subculture in the organization, and rewarding those living this new culture. Rewards do not have to be in financial terms. In Sharp's factory in Japan, top performers are rewarded by becoming members of the "gold badge" team that reports directly to the president. At any rate, CEOs must symbolize the culture they want to promote.

A clear vision of a common purpose elicits commitment. Moreover, when people participate in the decision-making process and exercise self-direction and self-control, they feel committed to their own plans. Espoused values, however, need to be reinforced through rewards and incentives, ceremonies, stories, and symbolic actions.

**LEADERSHIP PERSPECTIVE**

### Transformational Leadership of Mother Teresa[9]

When one thinks of powerful, transformational leaders, most people envision a political or business leader but not an Albania-born Catholic nun ministering to the poor in India. Yet, Mother Teresa, the Nobel Peace Prize winner was introduced to the United Nations as the most powerful woman. She founded the Missionaries of Charity in Calcutta and received India's highest civilian honor, the Bharat Ratna in 1980, the prize that was initiated by President Rajendra Prasad in 1954 for services that recognize scientific, literary, artistic, and public service.[10] She opened the first home for the dying in Calcutta in 1952. Later, her order opened leper houses, hospices, orphanages, and foundations in India, Venezuela, Rome, Austria, and other countries in Europe, Africa, Asia, and the United States. Mother Teresa did not learn her organizational skills in any business school; she probably never read a management book, but her vision and implementing it through example resulted in an organization that spread around the world with 610 missions in 123 countries at the time of her death in 1997. She even was a model for leadership and compassion for Jerry Brown, the former governor of California (2011) who worked with her in the Home for the Dying in India. ■■

## SUMMARY

Organizing involves developing an intentional structure of roles for effective performance. Many mistakes in organizing can be avoided by first planning the ideal organization for goal achievement and then making modifications for the human or other situational factors. Organization planning identifies staffing needs and helps overcome staffing deficiencies. It also discloses duplication of effort, unclear authority and communication lines, and obsolete ways of doing things. An effective organization remains flexible and adjusts to changes in the environment.

To make staff work effective, it is important to clarify authority relationships, to make line listen to staff, and to keep staff informed. Furthermore, effectiveness demands that staff prepare complete recommendations and that the utilization of staff becomes a way of organizational life.

Organizational conflict can be reduced by the use of organization charts and position descriptions. Organizing is improved by teaching its nature and by recognizing the informal organization and the grapevine. Moreover, effective enterprises develop and nurture an appropriate organization culture.

## KEY IDEAS AND CONCEPTS FOR REVIEW

- ✔ Avoiding mistakes in organizing by planning
- ✔ Avoiding organizational inflexibility
- ✔ Effective staff work
- ✔ Avoiding conflict by clarification
- ✔ Organization chart
- ✔ Position description
- ✔ Understanding of organizing
- ✔ Informal organization
- ✔ The grapevine
- ✔ Organization culture and values

## FOR DISCUSSION



1. Many psychologists have pointed to the advantage of job enlargement, which refers to assigning tasks that are not so specialized that an individual loses a sense of doing things that are meaningful. Assuming that managers wish to limit task specialization and "enlarge" jobs, can they do so and still apply the basic principles of organizing? How?
2. Taking an organized enterprise with which you have some familiarity, can you find any of the deficiencies that commonly occur in organization structures?
3. It is sometimes stated that the typical organization chart is undemocratic in that it emphasizes the superiority and inferiority of people and positions. Comment.
4. What would you need to know to plan an organization structure? How far ahead should you plan it? How would you go about making such a plan?
5. Take an organization that you know and discuss its culture. Is the culture helping or hindering the organization with respect to the achievement of its goals? In what ways?

## EXERCISE/ACTION STEPS

Visit a company in your area that is considered a model of effective management. Get any information on this company that gives you some insight into its operation. What makes this organization excellent? Would you like to work for this enterprise? Why or why not?

## INTERNET RESEARCH

1. Search the Internet for the term "organization planning" and locate the resources of organization planning on the Web.
2. Search the Internet for reviews of the book *In Search of Excellence* by Peters and Waterman.

## International Case Restructuring at Korea's Daewoo[11]

Daewoo was founded in 1967 by its hardworking, relentlessly driven chairman Kim Woo-Choong. After its initial success in exporting textiles, the company expanded into trade, autos, machinery, consumer electronics, construction, heavy shipping, computers, telephones, and financial services, becoming Korea's fourth largest business group. It became a textile supplier for Sears, Christian Dior, Calvin Klein, and London Fog. It also engaged in a joint venture with General Motors (GM) to build the Le Mans car. However, labor and other problems limited car shipments.

Chairman Kim's philosophy of hard work and the value placed in people were important factors in the firm's success. However, in the late 1980s and early 1990s, the company faced several problems. For one, Kim was concerned that, with the increasing prosperity of Koreans, the workforce might lose the spirit of hard work. Moreover, there was growing discontent among younger workers and decreasing motivation.

Through Kim's hands-off approach to managing, some of the companies in the Daewoo group went out of control. For example, in the unprofitable heavy shipping unit, he noticed many unnecessary expenses. The elimination of company-sponsored barbershops saved the company $8 million a year. In general, Daewoo's workforce was young and well educated. In contrast to similar positions in many other Korean companies, top positions at Daewoo were occupied by managers with no family ties.

Although Daewoo was a major company with its 91,000 employees, it was not dominant in any one industry. The strategy of being a supplier for major foreign companies, such as Caterpillar, GM, and Boeing, may have led to opportunities being bypassed for becoming a major marketer of its own brands. Now in the 1990s, Kim was also looking at opportunities in Europe; for example, he formed a joint venture with a distribution company in France.

The massive restructuring had already shown some positive effects. Kim sold some steel, financial, and real estate units. The hands-off managerial style had been replaced by a hands-on style, resulting in recentralization. Managers were "retired" or otherwise let go. Thousands of positions were also eliminated.

Things were looking better in 1991. The company lost money in 1988 and 1989 but made some profit in 1990 partly because of the sale of some major assets. The joint venture with GM registered a healthy growth. The company was also optimistic about the future of the new compact car Espero. Still, Daewoo had to cope with its labor costs and Japanese competition.

What looked good in the early 1990s dramatically changed in the latter part of that decade and especially in the years 2000 to 2002. In 2000, Ford planned to buy Daewoo Motor for some $7 billion. However, the deal fell apart later that year. Moreover, the company went bankrupt in November 2000. Chairman Kim mysteriously disappeared. He liked to think big, and he also left behind a company with big debts. Several billion dollars were also unaccounted for. With Ford out of the picture, GM entered seriously into negotiations with Daewoo, which was once Korea's second biggest car maker. On April 30, 2002, GM agreed to buy the bankrupt company, which was renamed GM-Daewoo. What is in it for GM? The acquisition is a key component of its global strategy. On the other hand, restructuring Daewoo is going to be a formidable task. The brand image has to be restored and the Korean market share of 10 percent (which was 37 percent in 1998) has to be improved. The product line also has to be reviewed and complemented with new models. Moreover, GM-Daewoo can expect difficulties with Korea's aggressive unions.

**Questions**

1. What are the advantages and disadvantages of a hands-off, decentralized management approach?
2. How can Daewoo stay competitive with the Japanese?
3. What were some of the controllable and uncontrollable factors in this case? How should Mr. Kim have responded to those factors?
4. What do you think of Daewoo's expansion into Europe? What are the advantages and risks for the company?
5. Why do you think GM acquired the company, while Ford did not?
6. What problems can GM-Daewoo expect in the future?

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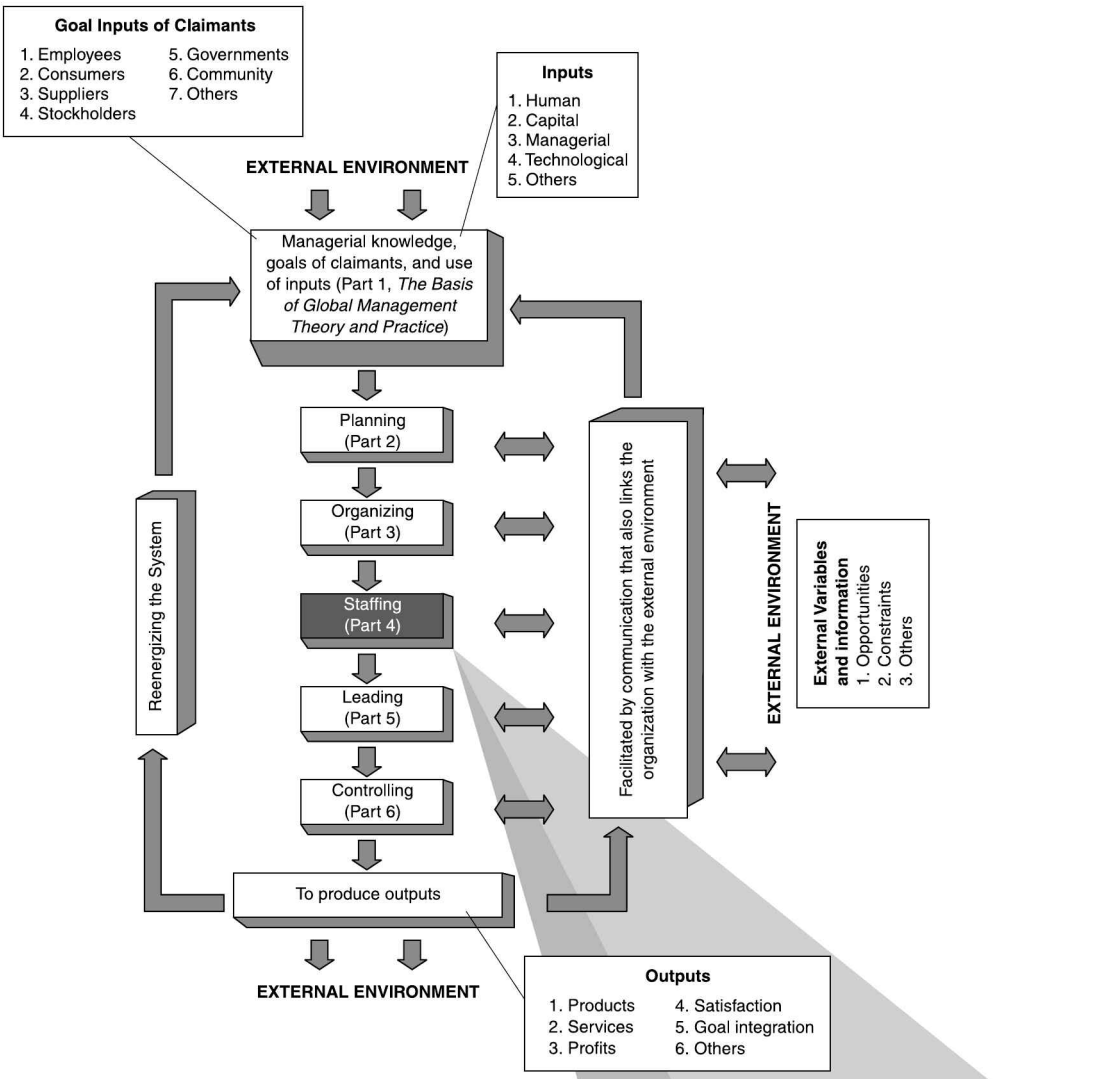



## SYSTEMS APPROACH TO MANAGEMENT: STAFFING

Part 4

11. Human Resource Management and Selection
12. Performance Appraisal and Career Strategy
13. Managing Change through Manager and Organization Development

# 11 Human Resource Management and Selection

## Chapter Objectives

After studying this chapter, you should be able to:

- Define the managerial function of staffing
- Describe the systems approach to human resource management
- Explain the management inventory and the factors in the external and internal environments affecting staffing
- Explain the policy of open competition and ways to make staffing more effective
- Summarize important aspects of the systems approach to manager selection
- Analyze position requirements, important characteristics of job design, and personal characteristics needed in managers
- Describe the process of matching manager qualifications with position requirements
- Discuss the orientation and socialization process for new employees

Few executives would argue with the fact that talented people are vital for the effective operation of a company. Managers often say that people are their most important asset. Yet the "human assets" are virtually never shown on the balance sheet as a distinct category, although a great deal of money is invested in the recruitment, selection, and training of people. It is for this reason that the late Rensis Likert and his colleagues suggested maintaining accounts of the valuable human assets. They refer to this process as "human resource accounting." This approach is not without its problems, and there is even conflict among management experts, between the proponents of human resource accounting and the financial people who have to develop the system for measuring human assets.[1] What is important here is the recognition that staffing is a crucial function of managers, one that may well determine the success or failure of an enterprise.

This chapter begins with a definition of the managerial function of staffing and an explanation of the role of the manager in this function. It then provides an overview of the systems approach to human resource management before concluding with a discussion of the various aspects of selecting the right person.

## DEFINITION OF STAFFING

**Staffing** Filling, and keeping filled, positions in the organization structure.

The managerial function of **staffing** is defined as filling, and keeping filled, positions in the organization structure. This is done by identifying workforce requirements, inventorying the people available, and recruiting, selecting, placing, promoting, appraising, planning the careers of, compensating, and training or otherwise developing both candidates and current job holders so that they can accomplish their tasks effectively and efficiently. It is clear that staffing must be closely linked to organizing, that is, the setting up of intentional structures of roles and positions.

Many writers on management theory discuss staffing as a phase of organizing. In this book, however, staffing is identified as a separate managerial function for several reasons. First, the staffing of organizational positions includes knowledge and approaches not usually recognized by practicing managers, who often think of organizing as just setting up a structure of roles and give little attention to filling these roles. Second, making staffing a separate function facilitates placing an even greater emphasis on the human element in personnel selection, appraisal, career planning, and manager development. Third, an important body of knowledge and experience has been developed in the area of staffing. The fourth reason for separating staffing is that managers often overlook the fact that staffing is their responsibility—not that of the personnel department. To be sure, this department provides valuable assistance, but it is the job of managers to fill the positions in their organization and to keep them filled with qualified people.

## THE SYSTEMS APPROACH TO HUMAN RESOURCE MANAGEMENT: AN OVERVIEW OF THE STAFFING FUNCTION[2]



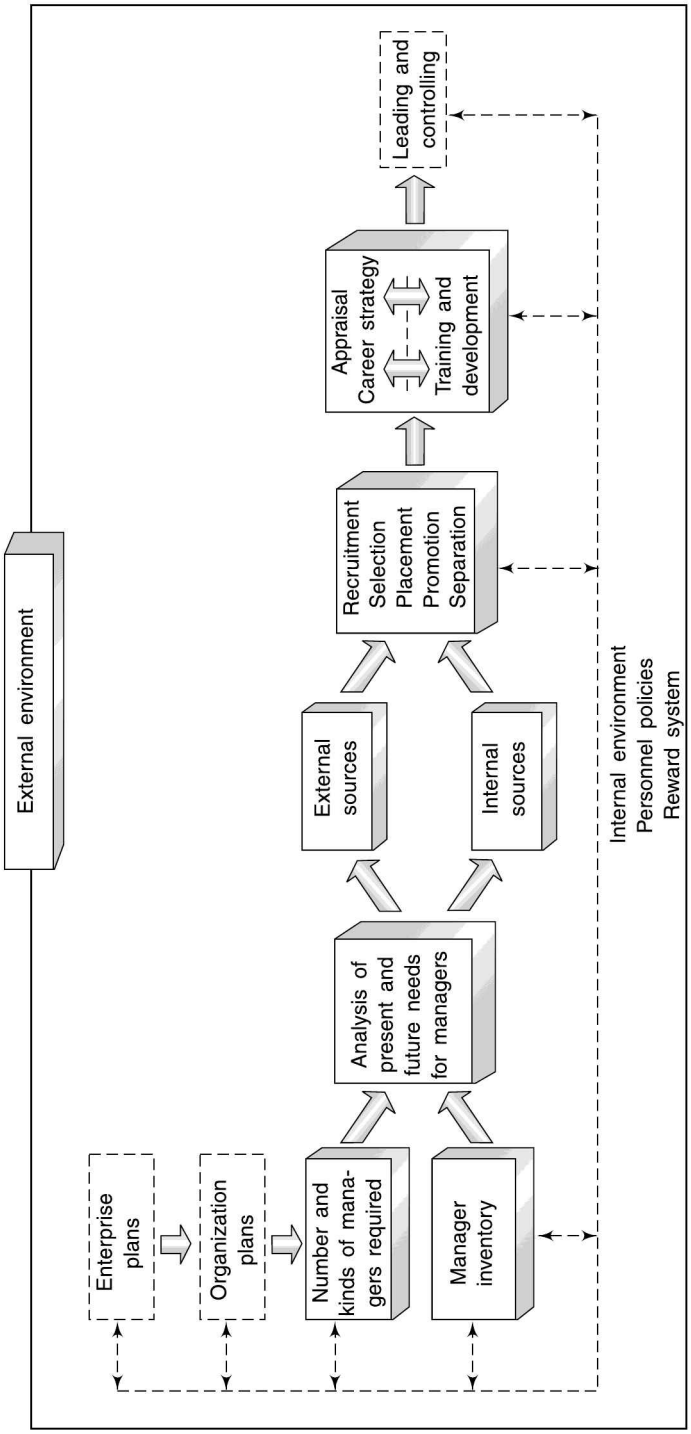
Figure 11.1 shows how the managerial function of staffing relates to the total management system. Specifically, enterprise plans become the basis for organization plans, which are necessary in order to achieve enterprise objectives. The present and projected organization structures determine the number and kinds of managers required. These demands are compared with available talent through the management inventory. On the basis of this analysis, external and internal sources are utilized in the processes of recruitment, selection, placement, promotion, and separation. Other essential aspects of staffing are appraisal, career strategy, and training and development of managers.

Staffing, as seen in the model, affects leading and controlling. For instance, well-trained managers create an environment in which people, working together in groups, can achieve enterprise objectives and at the same time accomplish personal goals. In other words, proper staffing facilitates leading. Similarly, selecting quality managers affects controlling, for example, by preventing many undesirable deviations from becoming major problems.

Staffing requires an open-system approach. It is carried out within the enterprise, which in turn is linked to the external environment. Therefore, internal factors of the firm—such as personnel policies, the organizational climate, and the reward system—must be taken into account. Clearly, without adequate rewards, it is impossible to attract and keep quality managers. The external environment cannot

**Figure 11.1**

**Systems Approach to Staffing.**
**The figure is an overview of the staffing function. The variables not discussed in Part 4, but which also affect staffing, are enclosed with broken lines. Enterprise plans are discussed in Part 2, organization plans in Part 3, and leading and controlling in Parts 5 and 6.**



be ignored either: high technology demands well-trained, well-educated, and highly skilled managers. Inability to meet the demand for such managers may well prevent an enterprise from growing at a desired rate.

## Factors Affecting the Number and Kinds of Managers Required

The number of managers needed in an enterprise depends not only on its size but also on the complexity of the organization structure, the plans for expansion, and the turnover rate of managerial personnel. The ratio between the number of managers and the number of employees does not follow any law. It is possible, by expanding or contracting the delegation of authority, to modify a structure so that the number of managers in a given instance will increase or decrease regardless the size of an operation.

Although the need for determining the number of managers required has been stressed here, it is clear that numbers are only part of the picture. Specifically, the qualifications for individual positions must be identified so that the best-suited managers can be chosen. This kind of detailed analysis of position requirements will be discussed later in this chapter.

## Determination of Available Managerial Resources: The Management Inventory

It is common for any business, as well as for most nonbusiness enterprises, to keep an inventory of raw materials and goods on hand to enable it to carry on its operation. It is far less common for enterprises to keep an inventory of available human resources, particularly managers, despite the fact that the required number of competent managers is a vital requirement for success. Keeping abreast of the management potential within a firm can be done by the use of an inventory chart (also called management replacement chart), which is simply an organization chart of a unit with managerial positions indicated and keyed as to the promotability of each incumbent.

Figure 11.2 depicts a typical manager inventory chart. At a glance, the controller can see where he or she stands with respect to the staffing function. The controller's successor is probably the manager of general accounting, and this person in turn has a successor ready for promotion. Supporting that person, in turn, is a subordinate who will be ready for promotion in a year, but below that position is one person who does not have potential and two newly hired employees.



**INTERNATIONAL PERSPECTIVE**

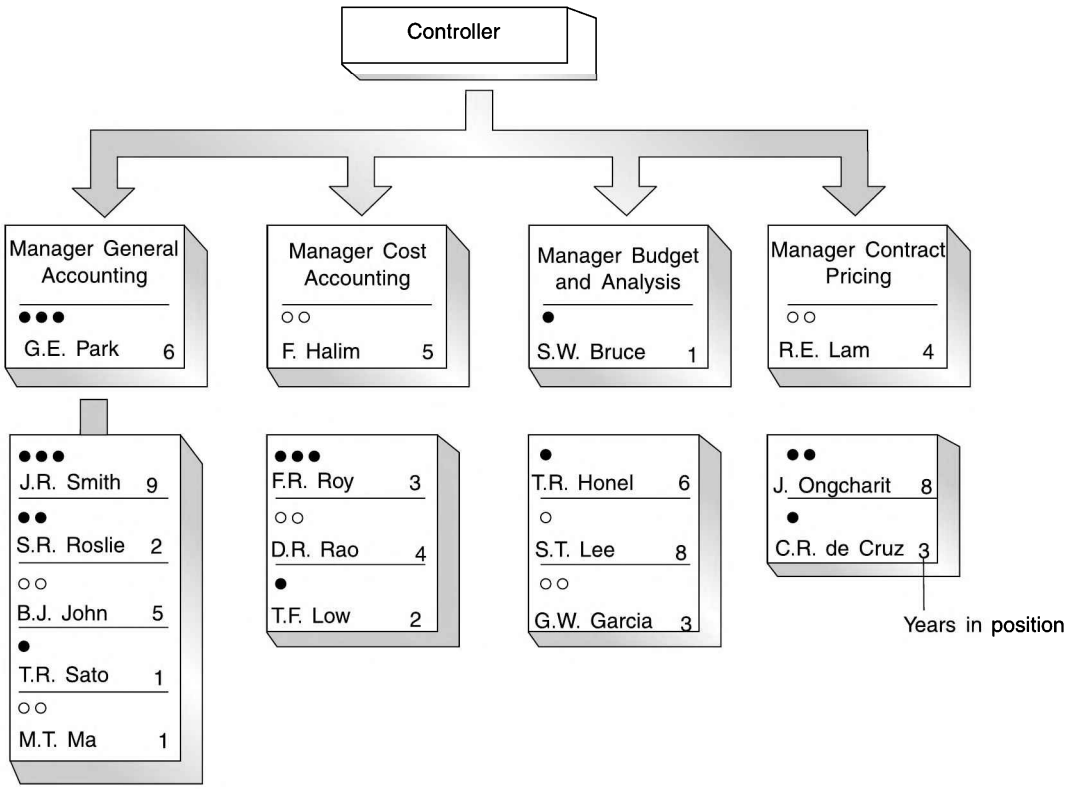
### Brain Drain at BMW[3]

www.bmw.com

BMW, the maker of luxury cars that wants to be known for producing the "ultimate driving machine," encountered the exodus of key managers after the failed association with British Rover. Bernd Pischetsrieder, the chief executive officer (CEO),

**Figure 11.2**

**Manager Inventory Chart.**




left for Volkswagen; the production manager, Carl-Peter Forster, left for Opel; Wolfgang Reitzle of the development and purchasing group moved to Ford, while his successor, Wolfgang Ziebart, is now at Continental Tire. One may wonder if a company with so much managerial talent drain can survive in the very competitive car industry.

Mr. Milberg, BMW's new CEO, ex-professor, and machine fitter apprentice in his formative years, is confident that BMW will do well as a niche player with 20 new models in the planning stage. The conventional wisdom is that organization size is essential to survival in the very competitive car industry; yet Mr. Milberg states that "There's no reason for BMW to merge with anyone."[4] Still, the strength or weakness of his managerial talent inventory must be on his mind. ■■

## Analysis of the Need for Managers: External and Internal Information Sources

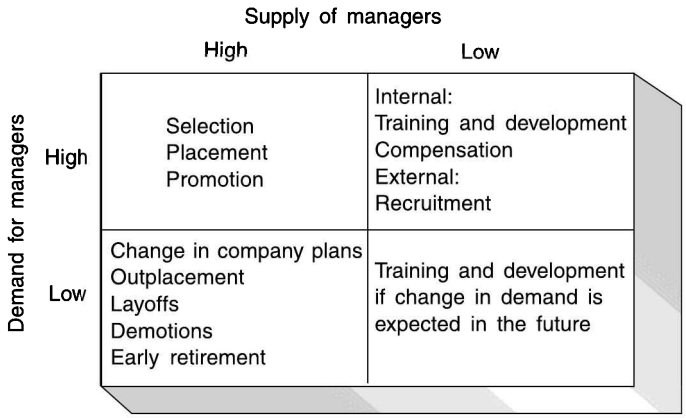
As shown in Figure 11.1, the need for managers is determined by enterprise and organization plans and, more specifically, by an analysis of the number of managers

required and the number available as identified through the management inventory. But there are other factors, internal and external, that influences the demand for and supply of managers. The external forces include economic, technological, social, political, and legal factors (which were discussed in Chapters 2 and 3). For example, economic growth may result in increased demand for a product, which in turn requires an expansion of the workforce, thus increasing the demand for managers. At the same time, competing companies may also expand and recruit from a common labor pool, thus reducing the supply of managers. One must also consider the trends in the labor market, the demographics, and the composition of the community with respect to knowledge and skills of the labor pool and the attitude toward the company. Information about the long-term trends in the labor market may be obtained from several sources. The U.S. Government, for example, publishes the *Monthly Labor Review* and the annual *Manpower Report of the President*, which makes long-term projections. Some trade associations and unions also project the demand for labor.

The need and the availability of personnel give rise to four demand and supply situations, each requiring a different emphasis in personnel actions. This is illustrated in the matrix shown in Figure 11.3.

**Figure 11.2**

**Personnel Actions Based on Manager Supply and Demand within the Enterprise.**




The demand for and supply of labor must not be viewed from a national, or even local, perspective only. On a global scale, we find the imbalance of demand and supply increasing. In the past, labor was very much a fixed factor of production. But in several developing countries, such as Taiwan, South Korea, Poland, and Hungary, the demand for qualified labor and managers has increased with their rapid economic development, resulting in labor shortages. The educational level of the global workforce is also changing, with the proportion of college graduates rising in developing countries such as China and Brazil.

LEADERSHIP PERSPECTIVE

## Can Leadership Be Transferred Between Industries?[5]

Alan Mulally was 40 some years with Boeing, an aircraft company before becoming CEO of Ford Motor Company–a car company. In selecting Mulally as CEO, some people were doubtful that he could succeed at Ford when he took over the job from Chairman and CEO William Ford. Can the experiences in the aircraft organization be transferred to running a mass-producing car company? The answer is "yes". Contributing to the success was that Mulally did not approach his new job as an autocrat; rather he focused on consensus and building a vision for Ford. He led by example by reducing his own salary by 30 percent for 2009-2010 to share in the sacrifices required by his employees, a measure necessary to cope with the effects of the financial crisis. Mulally's leadership style emphasized open communication and transparency. While optimistic and confident in his decisions, he showed great humility. Mulally demonstrates that a good leader can transfer his leadership skills from the aircraft to the automobile industry. ■■

## Other Important Aspects in the Systems Approach to Staffing

The staffing model shows that managers have to be recruited, selected, placed, and promoted.

After the need for managerial personnel has been determined, a number of candidates may have to be *recruited* (see Figure 11.1). This involves attracting qualified candidates to fill organizational roles. From these, managers or potential managers are *selected*; this is the process of choosing from among the candidates the most suitable ones. The aim is to *place* people in positions that allow them to utilize their personal strengths and, perhaps, overcome their weaknesses by getting experience or training in those skills in which they need improvement. Finally, placing a manager within the enterprise in a new position often means a *promotion*, which normally involves more responsibility. Since recruitment, selection, placement, and promotion are complex processes, they will be discussed in greater detail later in this chapter. Similarly, appraisal, career strategy, training, and development will be discussed in the following staffing chapters. The reference to leading and controlling in Figure 11.1 indicates that effective staffing influences these functions.

LEADERSHIP PERSPECTIVE

## Looking for a Company to Work For? Try Infosys

www.infosys.com

Located in Bangalore, India, Infosys is one of the largest information technology companies in India. It is a multinational company with several development centers in India and more than 80 offices around the world including offices in the United States, the UK, Canada, France, the United Arab Emirates, Argentina, Europe, and other countries. The company started in Pune in 1981 with little money. *Business*

*Today* rated Infosys as being the best employer in 2001. Other awards followed such as being "India's Most Respected Company in 2002."[6] It was also the first Indian firm to be listed in the NASDAQ 100 (National Association of Securities Dealers Automated).[7] ■■

## SITUATIONAL FACTORS AFFECTING STAFFING

The actual process of staffing shown in Figure 11.1 is affected by many environmental factors. Specifically, external factors include the level of education, the prevailing attitudes in society (such as the attitude toward work), the many laws and regulations that directly affect staffing, the economic conditions, and the supply of and demand for managers outside the enterprise.

There are also many internal factors that affect staffing. They include organizational goals, tasks, technology, organization structure, the kinds of people employed by the enterprise, the demand for and the supply of managers within the enterprise, the reward system, and various kinds of policies. Some organizations are highly structured; others are not. For some positions, such as that of a sales manager, skill in human relations may be of vital importance, while the same skill may be less critical for a research scientist working fairly independently in the laboratory. Effective staffing, then, requires recognition of many external and internal situational factors, but the focus here is on those that have a particular relevance to staffing.



**LEADERSHIP PERSPECTIVE**

### Why Leave a "Dream Job" at Microsoft?[8]

www.microsoft.com

Microsoft is well known for attracting exceptionally bright, ambitious people. Many have become multimillionaires during their tenure at Microsoft. So why would they leave the company? It has been estimated that about 50 or more depart each week. Many who left had been with the company from its early beginning, becoming very rich during that time. Still, the number leaving the company is only about half the industry average.

Due to the phenomenal growth of the company, the number of employees grew to over 30,000. Even with the best programs, a small-company atmosphere gives way to more structure with some loss of freedom to create and innovate. Microsoft probably has done a better job in maintaining an open corporate culture than most other firms. Still, some of the creative people feel constrained by the size of the corporation.

Changes in the external environment also have tempted many employees to leave. The Internet, new dot-com firms, and wireless service companies are offering new challenges. Although leaving Microsoft and joining start-up companies may mean considerable career risks, some still have the burning feeling to "change the world"—and this can often be better accomplished by joining a small, nimble

start-up firm exploiting the new technologies. For Microsoft, the loss of intellectual capital can be a serious threat—perhaps even more so than its competitors Sun and Oracle, or even the government threatening to break up the company. For many people, it was a difficult decision to leave a "dream job." ■■

## The External Environment

Factors in the external environment do affect staffing to various degrees. These influences can be grouped into educational, socio-cultural, legal–political, and economic constraints or opportunities. For example, the high technology used in many industries requires extensive and intensive education. Similarly, managers in the socio-cultural environment in the United States generally do not accept orders blindly but would want to become active participants in the decision-making process. Furthermore, now and in the future, managers will have to be more oriented toward the public than they have been in the past, responding to the public's legitimate needs and adhering to high ethical standards.

The economic environment, including the competitive situation, determines the external supply of and the demand for managers. Legal and political constraints require that organizations follow laws and guidelines issued by various levels of government. As examples, Table 11.1 summarizes major U.S. federal laws relating to fair employment that influence the staffing function. The following discussion focuses on equal employment opportunity and the role of women in management, as well as on the staffing of international businesses.

**Equal employment opportunity** Several laws have been passed in the United States that provide for equal employment opportunity. They prohibit employment practices that discriminate on the basis of race, color, religion, national origin, sex, or age (in specified age ranges). These laws impact on staffing, as recruitment and selection for promotion must be in compliance with them. This means that managers making decisions in these areas must be knowledgeable about these laws and the way they apply to the staffing function.

**Women in management** In the last decade or so, women have made significant progress in obtaining responsible positions in organizations. Among the reasons for this development are laws governing fair employment practices, changing societal attitudes toward women in the workplace, and the desire of companies to project a favorable image by placing qualified women in managerial positions.

**Diversity in the workplace**[9] Organizations today have a very diverse workforce. This is true not only in the United States, but also in other countries. In addition to higher ethnic and gender diversity, the average American worker and manager is also older. However, increasing diversity is also seen in education and the economic backgrounds.

The diverse workforce has implications for staffing such as recruitment, selection, training and development, work schedule flexibility, affirmative actions, provisions

**Table 11.1** Major U.S. Federal Laws Governing Equal Employment Opportunity

| *Law* | *Provision* |
|---|---|
| Equal Pay Act (1963) | Equal pay for equal work regardless of sex |
| Title VII of the Civil Rights Act (1964) (as amended in 1972) | Equal employment opportunity regardless of race, color, religion, sex, and national origin |
| Age Discrimination in Employment Act (1967) (as amended from ages 65 to 70 in 1978) | Equal employment opportunity for ages 40 to 70 |
| Vocational Rehabilitation Act (1973) | Equal employment opportunity and reasonable affirmative action for handicapped people |
| Pregnancy Discrimination Act (1978) | Equal employment opportunity during pregnancy |
| Immigration Reform and Control Act (1986) | Making illegal the hiring, recruitment, or referral of a person known to be an unauthorized alien |
| Americans with Disabilities Act (1990) | Better access for disabled persons to services and jobs |
| Older Workers Benefit Protection Act (1990) | Protection for employees over 40 years old with respect to fringe benefits; requirement that employees be given time to consider early-retirement offer |
| Civil Rights Act (1991) | Allowing women, persons with disabilities, and persons who are religious minorities to a jury trial as well as to suing for punitive damages in certain situations |
| Family and Medical Leave Act (1993) | Allowing qualified persons to have prolonged unpaid leave for family- and health-related reasons without fear of job loss |
| Sarbanes-Oxley Act (2002) | Passed partly in response to major corporate and accounting scandals including Enron and Tyco. It requires businesses to provide more disclosure and to adopt higher standards |



for preventing sexual harassment, and the establishment of an appropriate organization culture.

Working in a diverse workplace has many advantages, but also poses challenges for managers. The advantages may include bringing different perspectives to management and nonmanagerial issues, learning tolerating different views, developing behavioral flexibility and accepting that everyone is different.

The managerial challenges deal with communication problems, difficulty of reaching agreement, shifting from a monoculture to pluralism, and overcoming the ethnocentric outlook that assumes that his or her position is the only correct one. Many

companies, especially large corporations, have established diversity management programs.[10] McDonald's, Ford Motor Company, Allstate Insurance, IBM, Dole Food, and Xerox are just a few of those firms. Yet, conflicts will remain and need to be managed effectively as we have discussed in Chapter 10 and will again address in Chapter 13 where we discuss managing conflict.

**Staffing in the international environment**[11] One must look beyond the immediate external environment and recognize the worldwide changes brought about primarily by advanced communication technology and by the existence of multinational corporations. It is not unusual for large international firms to have top management teams composed of managers of many different nationalities. The geocentric attitude is the basis for viewing the organization as a worldwide entity engaged in global decision-making, including staffing decisions.

Companies have three sources for staffing the positions in international operations: (1) managers from the home country of the firm, (2) managers from the host country, and (3) managers from third countries. In the early stages of the development of an international business, managers are often selected from the home country. Some of the reasons include the managers' experience at the head office and their familiarity with products, personnel, enterprise goals and policies, and so on. This facilitates not only planning but also control. On the other hand, the home-country national may be unfamiliar with the language or the environment of the foreign country. Moreover, it is usually more expensive to send managers and their families abroad, and the family often find it difficult to adjust to the new environment of a foreign country. Also, host countries may pressurize the parent firm to employ host-country managers.

Managers who are host-country nationals speak the local language and are familiar with their country's environment. Employing them is generally less costly, and it may not require relocating them and their families. The problem is that those managers may not be familiar with the firm's products and operations, and thus control may be more difficult.

The other alternative is to employ third-country nationals, who often are international career managers. Still, the host country may prefer to have its own nationals in the positions of power. One has to be also cautious in selecting managers from countries that had political conflicts in the past. There are, of course, many other factors that have to be taken into account when operating abroad.

**LEADERSHIP PERSPECTIVE**

## Wipro's Development Center in Atlanta[12]

India's global information-technology-services company, Wipro, chose Atlanta for its software development center. The plan is to start small, but expand later. The idea is to use local people who know local business needs. Around Atlanta are 12 universities from which the center will draw local talents. But this global expansion of Wipro is not new because it has already more than 12 offices in the U.S. ■■

## The Internal Environment

The internal factors selected for this discussion concern staffing managerial positions—with personnel from within the firm as well as from the outside—and determining the responsibility for staffing.

**Promotion from within** Originally, promotion from within implied that workers proceeded into first-line supervisory positions and then upward through the organization structure. Thus, a firm was pictured as receiving a flow of nonmanagerial employees from which future managers emerged. As used to be said in the railroad industry, "When a president retires or dies, we hire a new office worker."

As long as the matter is considered in general terms, there is little doubt that employees overwhelmingly favor a policy of promotion from within. The banning of outsiders reduces competition for positions and gives employees an established monopoly on managerial openings. Employees come to doubt the wisdom of the policy, however, when they are confronted with a specific case of selection of one of their own for promotion. This feeling is present at all levels of the organization, largely because of jealousy or because of rivalry for promotion. The difficulty becomes most evident when a general manager is being selected from among the sales, production, finance, or engineering managers. Top managers are often inclined to choose the easy way and avoid problems by selecting an outsider.

Promoting from within the enterprise not only has positive values relating to morale, employees' long-run commitment to the company, and the firm's reputation, but it also allows the enterprise to take advantage of the presence of potentially fine managers among its employees. However, although these positive but unmeasurable values are important, executives should not be blind to the dangers of either overemphasizing this source or relying on it exclusively.

A danger presented by a policy of exclusively promoting from within is that it may lead to the selection of persons who have, perhaps, only imitated their superiors. This is not necessarily a fault, especially if only the best methods, routines, and viewpoints are cultivated, but this is likely to be an unapproachable ideal. The fact is that enterprises often need people from the outside to introduce new ideas and practices. Consequently, there is good reason to avoid a policy of exclusive promotion from within.



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www.gm.com

**Promotion from within in large companies** On the other hand, a policy of promotion from within may be quite suitable for very large companies such as Sears, Du Pont, or General Motors. Large business and nonbusiness organizations usually have so many qualified people that promotion from within actually approaches a condition similar to an open-competition policy. Even in these large companies, however, it may be necessary to go outside, as General Motors did when it hired a university professor as vice president to head its environmental control staff.

INTERNATIONAL PERSPECTIVE

## Managing Human Resources at Wal-Mart[13]

Wal-Mart is the largest U.S. private employer with over a million people. Sam Walton, the founder of the company, had a special rapport with his employees, called associates. Although he died in 1992, he is lovingly remembered for his caring, his concern, his listening to them, and his open-door policy. His legacy continues. He was lovingly called Mr. Sam, who showed his concern for people by initiating a policy of paying a time and a half for working on Sundays. Wal-Mart paid low wages, yet employees were generally happy, which was one of the reasons the company grew rapidly. The importance of people is also shown in the associates' handbook: "The undeniable cornerstone of Wal-Mart's success can be traced back to our strong belief in the dignity of each individual."

Sam's successors tried to maintain the organizational climate—and succeeded to a great extent. But things are changing, ranging from the elimination of the 50 percent extra pay for Sunday work to demands created by the long store hours, such as unsuitable working hours in stores that are open 24 hours. The change in orientation may also be shown by the slogan on the blue aprons associates wear. It changed from "Our people make the difference" to "How may I help you?" which could be interpreted as a change in focus from the associate to the customer. Taking advantage of the concern of some associates, labor unions try to recruit members in some locations.

Although Wal-Mart is still very successful, its growth has slowed. The challenge is to maintain a concerned human organization despite its size. ■■

**Principle of open competition** Vacant positions should be opened to the best-qualified persons available, whether inside or outside the enterprise.

**The policy of open competition** Managers must decide whether the benefits of a policy of promotion from within outweigh its shortcomings. There are clear-cut reasons for implementing the **principle of open competition** by opening vacant positions to the best-qualified persons available, whether inside or outside the enterprise. It gives the firm, in the final analysis, the opportunity to secure the services of the best-suited candidates. It counters the shortcomings of a policy of exclusive promotion from within, permits a firm to adopt the best techniques in recruiting managers, and motivates the complacent "heir apparent." To exchange these advantages for the morale, advantages attributed to internal promotion would appear questionable.

A policy of open competition is a better and more honest means of ensuring managerial competence than is obligatory promotion from within. However, it does put the managers who use it under a special obligation. If morale is to be protected in applying an open-competition policy, the enterprise must have fair and objective methods of appraising and selecting its people. It should also do everything possible to help them develop so that they can qualify for promotion.

When these requirements are met, it would be expected that every manager making an appointment to a vacancy or a new position would have available a roster of qualified candidates within the entire enterprise. If people know that their qualifications are being considered, if they have been fairly appraised and have been given opportunities for development, they are far less likely to feel a sense of injustice if an opening goes to an outsider. Other things being equal, present employees should be able to compete with outsiders. If a person has the ability for a position, he or she has the considerable advantage of knowing the enterprise and its personnel, history, problems, policies, and objectives. For the superior candidate, the policy of open competition should be a challenge and not a hindrance to advancement.

**Responsibility for staffing** While responsibility for staffing should rest with every manager at every level, the ultimate responsibility is with the CEO and the policy-making group of top executives. They have the duty of developing policy, assigning its execution to subordinates, and ensuring its proper application. Policy considerations include decisions about the development of a staffing program, the desirability of promoting from within or securing managers from the outside, the sources of candidates, the selection procedure to follow, the kind of appraisal program to use, the nature of manager and organization development, and the promotion and retirement policies to follow.

Line managers should certainly make use of the services of staff members, usually from the personnel department, in recruiting, selecting, placing, promoting, appraising, and training people. In the final analysis, however, it is the manager's responsibility to fill positions with the best-qualified persons.



## SELECTION: MATCHING THE PERSON WITH THE JOB

**Selection** Choosing from among candidates, from within or outside the organization, the most suitable person for a position.

Plant, equipment, materials, and people do not make a business any more than airplanes, tanks, ships, and people make an effective military force. One other element is indispensable: effective managers. The quality of managers is one of the most important factors determining the continuing success of any organization. It necessarily follows, therefore, that the selection of managers is one of the most critical steps in the entire process of managing. **Selection** is the process of choosing from among candidates, from within the organization or from the outside, the most suitable person for the current position or for future positions.

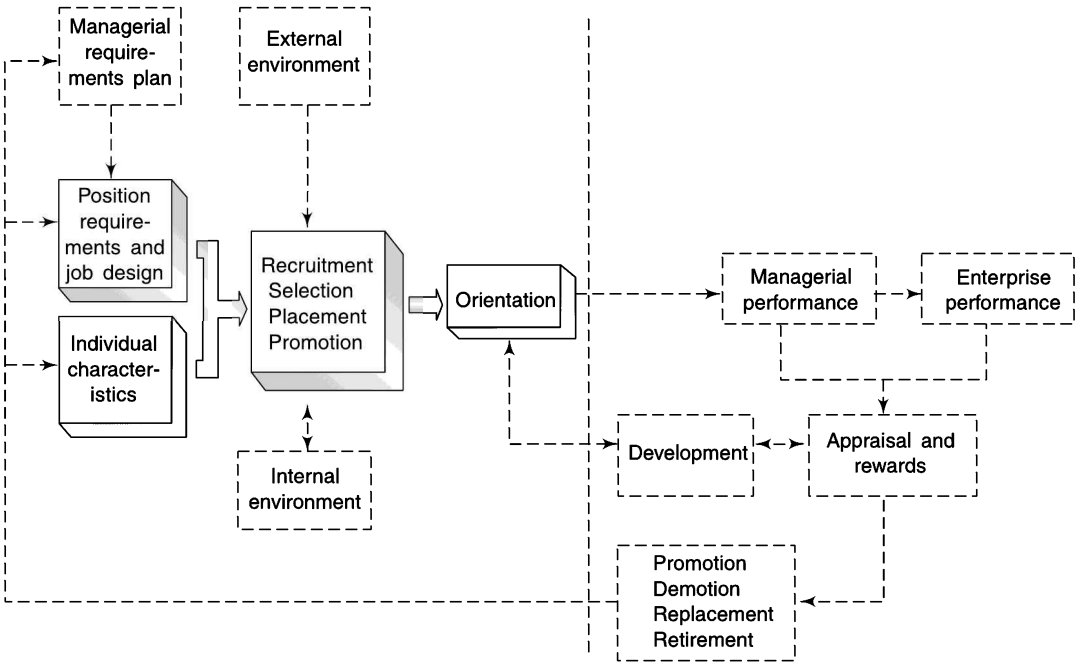
## THE SYSTEMS APPROACH TO SELECTION: AN OVERVIEW

Since qualified managers are critical to the success of an enterprise, a systematic approach is essential to manager selection and to the assessment of present and future needs for managerial personnel. An overview of the systems approach to selection is illustrated in Figure 11.4. The managerial requirements plan is based on the firm's objectives, forecasts, plans, and strategies. This plan is translated into position requirements and job design, which are matched with such individual characteristics as intelligence, knowledge, skills, attitudes, and experience. To meet organizational requirements, managers recruit, select, place, and promote people. This, of course,

**Figure 11.4**

**Systems Approach to Selection.**

**Variables marked with broken lines are staffing and other activities that are discussed in other chapters.**




must be done with due consideration for the internal environment (e.g., company policies, manager supply and demand, and the organizational climate) and the external environment (laws, regulations, availability of managers). After people have been selected and placed in positions, they must be introduced to the new job. This orientation involves learning about the company, its operation, and its social aspects.

The newly placed managers then carry out their managerial and nonmanagerial functions (such as marketing), and the resulting managerial performance will eventually determines enterprise performance. Subsequently, managerial performance is appraised, and managers who meet their performance goals are rewarded (see Chapter 12). On the basis of this evaluation, manager and organization development is initiated (Chapter 13). Finally, appraisal may also become the basis for promotion, demotion, replacement, and retirement decisions.

That is the selection model in brief; now each major variable in the model will receive closer attention.

LEADERSHIP PERSPECTIVE

### What Do You Do after You Retire or Get Fired?[14]

Companies such as Dow Chemical encourage former employees to stay in contact with the firm, similar as universities say "keep in touch with the *alma mater*." The idea is to develop an alumni social network by using networks such as Twitter, LinkedIn, or Facebook. This may benefit the company as well as the employee. One such benefit is the sharing of knowledge that may also result in reemployment after separation. There is, however, a potential downside. A fired or laid-off employee may use the social network for venting grievances against the company. Social networking, like most technologies, has the potential not only for benefitting not only the company and its retired employees, but also preventing non-desired spreading of false information. ■■

## POSITION REQUIREMENTS AND JOB DESIGN

Selecting a manager effectively requires a clear understanding of the nature and purpose of the position that is to be filled. An objective analysis of position requirements must be made and, as far as possible, the job must be designed to meet organizational and individual needs. In addition, positions must be evaluated and compared so that the incumbents can be treated equitably. Among other factors to consider are the skills required, since they vary with the level in the organizational hierarchy, and the personal characteristics desired in managers.



### Identifying Job Requirements

In identifying job requirements, firms must answer questions such as these: What has to be done in this job? How is it done? What background knowledge, attitudes, and skills are required? Since positions are not static, additional questions may have to be considered: Can the job be done differently? If so, what are the new requirements? Finding answers to these and similar questions requires that the job be analyzed. This can be done through observation, interviews, questionnaires, or even a systems analysis. Thus, a job description, based on job analysis, usually lists important duties, authority–responsibility, and the relationship to other positions. Many firms also include objectives and expected results in job descriptions.

There is, of course, no foolproof rule for designing managerial jobs. Nevertheless, firms can avoid mistakes by following some guidelines.

**Appropriate scope of the job** A job too narrowly defined provides no challenge, no opportunity for growth, and no sense of accomplishment. Consequently, good managers will be bored and dissatisfied. On the other hand, a job must not be so broad that it cannot be effectively handled. The result will be stress, frustration, and loss of control.

**Meeting managerial skills required by job design** Generally, the design of the job should start with the tasks to be accomplished. The design is usually broad enough to accommodate people's needs and desires. But some writers on management suggest that it may be necessary to design the job to fit the leadership style of a particular person. It may be especially appropriate to design jobs for exceptional persons in order to utilize their potential. The problem, of course, is that such a position would probably have to be restructured every time a new manager occupies it. The job description, then, must provide a clear idea of the performance requirements for a person in a particular position but must also allow some flexibility so that the employer can take advantage of individual characteristics and abilities.

Any position description is contingent on the particular job and the organization. For example, in a bureaucratic and fairly stable organizational environment, a position may be described in relatively specific terms. In contrast, in a dynamic organization with an unstable, fast-changing environment, a job description may have to be more general and most likely will have to be reviewed more frequently. A situational approach to job description and job design is called for.

## Job Design

People spend a great deal of time on the job, and it is therefore important to design jobs so that individuals feel good about their work. This requires an appropriate job structure in terms of content, function, and relationships.

**Design of jobs for individuals and work teams** The focus of job design can be on the individual position or on work groups. First, individual jobs can be enriched by grouping tasks into natural work units. This means putting tasks that are related into one category and assigning an individual to carry out the tasks. A second related approach is to combine several tasks into one job. For example, rather than having the tasks of assembling a water pump carried out by several persons on the assembly line, workstations can be established with individuals doing the whole task of putting the unit together and even testing it. A third way of enriching the job is to establish direct relationships with the customer or client. Rather than reporting to his or her superior, who would then make the recommendations to top management, a systems analyst may present findings and recommendations directly to the managers involved in the systems change. Fourth, prompt and specific feedback should be built into the system whenever appropriate. In one retail store, for example, salespersons received sales figures for each day and summary figures for each month. Fifth, individual jobs can be enriched through vertical job loading, which means increasing individuals' responsibility for planning, doing, and controlling their job.

Similar arguments can be made for improving the design of jobs for work teams. Jobs should be designed so that groups have a complete task to perform. Moreover, teams may be given a great deal of autonomy in the form of authority and freedom to decide how well the jobs shall be performed. Within the team, individuals can often be trained so that they can rotate to different jobs within the group. Finally, rewards may be administered on the basis of group performance, which tends to induce cooperation rather than competition among team members.

**Factors influencing job design** In designing jobs, the requirements of the enterprise have to be taken into account. But other factors must also be considered in order to realize maximum benefits; they include individual differences, the technology involved, the costs associated with restructuring the jobs, the organization structure, and the internal climate.

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People have different needs. Those with unused capabilities and a need for growth and development usually want to have their job enriched and to assume greater responsibility. While some people prefer to work by themselves, others with social needs usually work well in groups. The nature of the task and the technology related to the job must also be considered. While it may be possible for work teams to assemble automobiles, as it was done at a Volvo plant in Sweden, it may not be efficient to use the same work design for the high production runs at General Motors in the United States. The costs of changing to new job designs must also be considered. It makes a great deal of difference whether a plant is newly designed or an old plant has to be redesigned and changed to accommodate new job design concepts.

The organization structure must also be taken into account. Individual jobs must fit the overall structure. Autonomous work groups, for example, may work well in a decentralized organization, but they may be inappropriate in a centralized structure. Similarly, the organizational climate influences job design. Groups may function well in an atmosphere that encourages participation, job enrichment, and autonomous work, while they may not fit into an enterprise with an autocratic, top-down approach to managerial leadership.



## SKILLS AND PERSONAL CHARACTERISTICS NEEDED IN MANAGERS

To be effective, managers need various skills: technical, human, conceptual, and design. The relative importance of these skills varies according to the level in the organization, as discussed in Chapter 1. In addition, analytical and problem-solving abilities and certain personal characteristics are sought in managers.

### Analytical and Problem-solving Abilities

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One of the frequently mentioned skills desired of managers is analytical and problem-solving ability. As Alan Stoneman, former president of Purex Corporation, used to say, "We have no problems here; all are opportunities; all a problem should be is an opportunity." In other words, managers must be able to identify problems, analyze complex situations, and, by solving the problems encountered, exploit the opportunities presented. They must scan the environment and identify, through a rational process, those factors that stand in the way of opportunities. Thus, analytical skills should be used to find the needs of present customers—or potential ones—and then to satisfy those needs with a product or service. It has been amply demonstrated that this opportunity-seeking approach can mean corporate success. For example, Edwin H. Land of Polaroid filled the needs of people who wanted instant photographs. But problem identification and analysis are not enough. Managers also need

the will to implement the solutions; they must recognize the emotions, needs, and motivations of the people involved in initiating the required change as well as of those who resist change.

## Personal Characteristics Needed in Managers

In addition to the various skills that effective managers need, several personal characteristics are also important. They are a desire to manage; the ability to communicate with empathy; integrity and honesty; and experience as manager, which is a very significant characteristic.

**Desire to manage** The successful manager has a strong desire to manage, to influence others, and to get results through the team efforts of subordinates. To be sure, many people want the privileges of managerial positions, which include high status and salary, but they lack the basic motivation to achieve results by creating an environment in which people work together toward common aims. The desire to manage requires effort, time, energy, and, usually, long hours of work.

**Intragroup communication** Communication with people in the same organizational unit.

**Intergroup communication** Communication with other departments as well as with groups outside the enterprise.

**Communication skills and empathy** Another important characteristic of managers is the ability to communicate through written reports, letters, speeches, and discussions. Communication demands clarity but, more than that, it demands empathy. This is the ability to understand the feelings of another person and to deal with the emotional aspects of communication. Communication skills are important for effective **intragroup communication**, that is, communication with people in the same organizational unit. As one moves up in the organization, however, **intergroup communication** becomes increasingly important. This is communication not only with other departments but also with groups outside the enterprise: customers, suppliers, governments, the community, and the stockholders in business enterprises.

**Integrity and honesty** Managers must be morally sound and worthy of trust. Integrity in managers includes honesty in money matters and in dealing with others, adherence to the full truth, strength of character, and behavior in accordance with ethical standards.

www.ford.com

Many of these qualities, and others, have been cited by top executives of major companies. For example, Henry Ford II, former chairman of Ford Motor Company, considers as appealing qualities honesty, candor, and openness.

**Past performance as manager** Another very important characteristic for selection is past performance as a manager. It is probably the most reliable forecast of a manager's future performance. Of course, an assessment of managerial experience is not possible in selecting first-line supervisors from the ranks since they have not had such experience. But past accomplishments are important considerations in the selection of middle- and upper-level managers.

## MATCHING QUALIFICATIONS WITH POSITION REQUIREMENTS

After the positions are identified, managers are obtained through recruitment; selection, placement, and promotion (see Figure 11.4). There are basically two sources of managerial personnel: (1) promotion or transfer of people from within the enterprise and (2) hiring from the outside. For internal promotions, a computerized information system may help identify qualified candidates. It can be used in conjunction with a comprehensive human resource plan. Specifically, it can be utilized to anticipate staff requirements, new openings, attritions, development needs, and career planning.

There are several external sources available, and the enterprise may use different channels to find qualified managers. Many employment agencies—public and private—and executive recruiters (sometimes called headhunters) locate suitable candidates for positions. Other sources of managers are professional associations, educational institutions, referrals from people within the enterprise, and unsolicited applications from persons interested in the firm.

### Recruitment of Managers

**Recruiting** Attracting candidates to fill positions in the organization structure.

**Recruiting** involves attracting candidates to fill the positions in the organization structure. Before recruiting begins, the position's requirements, which should relate directly to the task, must be clearly identified to facilitate recruitment from the outside. Enterprises with a favorable public image find it easier to attract qualified candidates. A company such as Sony has a well-recognized image, while small firms—which frequently offer excellent growth and development opportunities—may have to make great efforts to communicate to applicants the kind of business they do and the opportunities they offer.



**LEADERSHIP PERSPECTIVE**

#### Where Do Chinese Companies Recruit?[15]

As Chinese companies become more globally oriented, many now hire Western managers. Lenovo, the biggest computer maker in China, hired Bill Amelio as CEO. Mr. Amelio was the head of Dell Computer's Asia-Pacific region. Similarly, Phil Murtaugh migrated from General Motors to Shanghai Automotive Industry Corp (SAIC) which is China's largest car company that may produce cars for export. As can be expected, some local Chinese firms have reservations about such practices, but increasingly top jobs in China became attractive for Western executives. Still, for those executives such a switch is risky because they are not familiar with the detailed knowledge of Chinese culture. A number of Chinese companies now hire Chinese executives with western experience who have the advantage of being familiar with the Chinese environment.

There is also a great need for middle managers in China because the Cultural Revolution hindered their education. As Chinese companies become globally oriented, the need for top as well as middle managers is increasing which opens attractive opportunities for some westerners. ■■

### Selection, Placement, and Promotion

Two approaches to filling positions: selection and placement.

Selecting a manager is choosing from among the candidates the one who best meets the position requirements. Since the selection may be for a specific job opening or for future managerial requirements, there are two approaches to filling organizational positions. In the *selection approach*, applicants are sought to fill a position with rather specific requirements; while in the *placement approach*, the strengths and weaknesses of the individual are evaluated, and a suitable position is found or even designed.

*Promotion* is a move within the organization to a higher position that has greater responsibilities and requires more advanced skills. It usually involves a raise in status and in pay. The various facets of selection generally apply also to promotion, which may be a reward for outstanding performance or a result of the firm's desire to better utilize an individual's skills and abilities. Promotions may be a reward for past performance, but only if there is evidence of potential competency; otherwise, the persons may be promoted to a level at which they are incompetent.

### The Peter Principle

Errors in selection are possible, perhaps even common. According to Laurence J. Peter and Raymond Hall, authors of *The Peter Principle*, managers tend to be promoted to the level of their incompetence.[16] Specifically, if a manager succeeds in a position, this very success may lead to promotion to a higher position, often one requiring skills that the person does not possess. Such a promotion may involve work that is over the manager's head. While the possibility of individual growth must not be overlooked, the Peter Principle can serve as a warning not to take the selection and promotion process lightly.

## SELECTION PROCESS, TECHNIQUES, AND INSTRUMENTS

**Validity** The degree to which the data predict the candidate's success as a manager.

**Reliability** The accuracy and consistency of the measurement.

This section presents an overview of the selection process, followed by a discussion of a number of selection instruments and techniques, including interviews, tests, and the assessment center approach. For good selection, the information about the applicant should be both valid and reliable. When people ask if data are valid, they are asking if the data are measuring what they are supposed to be measuring. In selection, **validity** is the degree to which the data predict the candidate's success as a manager. The information should also have a high degree of **reliability**, a term that refers to the accuracy and consistency of the measurement. For example, a reliable test, if repeated under the same conditions, would give essentially the same results.

### The Selection Process

There are some variations of the specific steps in the selection process. For example, the interview of a candidate for a first-line supervisory position may be relatively simple when compared with the rigorous interviews for a top-level executive. Nevertheless, the following broad outline is indicative of the typical process.

First, the selection criteria are established, usually on the basis of current, and sometimes future, job requirements. These criteria include such items as education, knowledge, skills, and experience. The candidate is then requested to complete an application form (this step may be omitted if the candidate is from within the organization). A screening interview follows to identify the more promising candidates. Additional information may be obtained by testing the candidate's qualifications for the position. Formal interviews are then conducted by the manager, his or her superior, and other persons within the organization. The information provided by the candidate is checked and verified. A physical examination may be required. Finally, on the basis of the information gathered, the candidate is either offered the job or informed that he or she has not been selected for the position. Let us examine some parts of the selection process in greater detail.

## Interviews

Virtually every manager hired or promoted by a company is interviewed by one or more people. Despite its general use, the interview is considerably distrusted as a reliable and valid means for selecting managers. Different interviewers may weigh or interpret the gathered information differently. Interviewers often do not ask the right questions. They may be influenced by the interviewee's general appearance, which may have little bearing on job performance. They also frequently make up their minds early in the interview, before they have all the information necessary to make a fair judgment.

Several techniques can be used to improve the interviewing process and overcome some of these weaknesses. First, interviewers should be trained so that they know what to look for. For example, in interviewing people from within the enterprise, they should analyze and discuss past records. They should study the results achieved as well as the way key managerial activities were performed. Chapter 12, on performance appraisal, shows in greater detail how this can be done. When selecting managers from outside the firm, these data are more difficult to obtain, and interviewers usually get them by checking with the listed references.

Second, interviewers should be prepared to ask the right questions. There are structured, semistructured, and unstructured interviews. In an *unstructured* interview, an interviewer may say something like "Tell me about your last job." In the *semistructured* interview, the interviewer follows an interview guide but may also ask other questions. In a *structured* interview, the interviewer asks a set of prepared questions.

A third way to improve selection is to conduct multiple interviews utilizing different interviewers. Thus, several people can compare their evaluations and perceptions. However, not all interviewers should vote in selecting a candidate; rather, their role is to provide additional information for the manager who will be responsible for the final decision.

Fourth, the interview is just one aspect of the selection process. It should be supplemented by data from the application form, the results of tests, and the information obtained from persons listed as references. Reference checks and letters of recommendation may be necessary to verify the information given by the applicant.

For a reference to be useful, the person must know the applicant well and give a truthful and complete assessment of the applicant. Many people are reluctant to provide information that may jeopardize an applicant's chances, and so the applicant's strong points are often overemphasized while shortcomings may be omitted or glossed over. In the United States, the Privacy Act of 1974 and related legislation and judicial rulings have made it even more difficult to obtain objective references. Under the Privacy Act, the applicant has a legal right to inspect letters of reference, unless this right is waived. This is one of the reasons that teachers are sometimes reluctant to make objective and accurate job referrals for their students.

## Tests

The primary aim of testing is to obtain data about applicants that help predict their probable success as managers. Some of the benefits from testing include finding the best person for the job, obtaining a high degree of job satisfaction for the applicant, and reducing turnover. Some of the commonly used tests can be classified as follows:

- *Intelligence tests* are designed to measure mental capacity and to test memory, speed of thought, and ability to see relationships in complex problem situations.
- *Proficiency and aptitude tests* are constructed to discover interests, existing skills, and potential for acquiring skills.
- *Vocational tests* are designed to indicate a candidate's most suitable occupation or the areas in which the candidate's interests match the interests of people working in those areas.
- *Personality tests* are designed to reveal a candidate's personal characteristics and the way the candidate may interact with others, thereby giving a measure of leadership potential.

Tests, however, have a number of limitations. First, competent industrial psychologists agree that tests are not accurate enough to be used as the sole measure of candidates' characteristics but must be interpreted in light of each individual's entire history. Second, the test user must know what tests do and what their limitations are. One of the major limitations is uncertainty about whether tests are really applicable; even psychologists are not highly confident that present-day tests are effective in measuring managerial abilities and potentials. Third, before any test is widely used, it should be tried out, if possible on existing personnel, to see whether it is valid for employees whose managerial abilities are already known. Fourth, it is also important that tests be administered and interpreted by experts in the field. Finally, tests should not discriminate unfairly and should be consistent with laws and government guidelines.

## Assessment Centers

**Assessment center** A technique for selecting and promoting managers.

The **assessment center** is not a location but a technique for selecting and promoting managers. This approach may be used in combination with training. Assessment centers were first used for selecting and promoting lower-level supervisors, but now they are applied to middle-level managers as well. They seem, however, to be inappropriate for top executives. The assessment center technique is not new. It was

used by the German and British military in World War II and the American Office of Strategic Services. But its first corporate use in the United States is generally attributed to the American Telephone and Telegraph Company in the 1950s.

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Intended to measure how a potential manager will act in typical managerial situations, the usual center approach is to have candidates take part in a series of exercises. During this period, they are observed and assessed by psychologists or experienced managers. A typical assessment center will have the candidates do the following: take various psychological tests; engage in management games in small groups; engage in "in-basket" exercises, in which they are asked to handle a variety of matters that they might face in a managerial job; participate in a leaderless group discussion of some problem; give a brief oral presentation on a particular topic or theme, usually recommending a course of desirable action to a mythical superior; and engage in various other exercises, such as preparing a written report.

During these exercises, the candidates are observed by their evaluators, who also interview them from time to time. At the end of the assessment center period, the assessors summarize their own appraisal of each candidate's performance; then they compare their evaluations, come to conclusions concerning each candidate's managerial potential, and write a summary report on each candidate. These reports are made available to appointing managers for their guidance. They are also often used as guides for management development. In many cases, candidates are given feedback on their evaluation; in other cases, feedback is given only when candidates request it. Sometimes the overall evaluation as to promotability remains confidential, even though candidates may be informed by assessors about their performance in the various exercises.

Evidence of the usefulness of the assessment center approach, although not conclusive, is encouraging. On the other hand, there is controversy over to whom, by whom, and under what circumstances this and other tests should be administered and as to who should receive the test results.

Assessment centers do present some problems. First, they are costly in terms of time, especially since many effective programs extend over a five-day period. Second, training assessors is a problem, particularly in companies that believe, with some justification, that the best assessors are likely to be experienced line managers rather than trained psychologists. Third, although a number of different exercises are used to cover the kinds of things a manager does, questions have been raised as to whether these exercises are the best criteria for evaluation. An even greater problem exists in determining which evaluation measures should be applied to each exercise. Most assessment centers, being highly oriented to individual and interpersonal behavior under various circumstances, may be overlooking the most important element in selecting managers, especially those about to enter the managerial ranks for the first time. That element is motivation—whether or not a person truly wants to be a manager. To be so motivated, candidates must know what managing is, what it involves, and what is required to be a successful manager. Obviously, motivation is a difficult quality to evaluate. However, by making clear to a candidate what managing involves and requires and then asking the candidate to think this over, the interviewer can give the candidate a good basis on which to determine whether he or she really wants to be a manager.

## Limitations of the Selection Process

The diversity of selection approaches and tests indicates that there is no one perfect way to select managers. Experience has shown that even carefully chosen selection criteria are still imperfect in predicting performance. Furthermore, there is a distinction between what persons can do—that is, their ability to perform—and what they will do, which relates to motivation. The latter is a function of the individual and the environment. For example, a person's needs may be different at various times. The organizational environment also changes. The climate of an enterprise may change from one that encourages initiative to one that restricts it because a new top management introduces a different managerial philosophy. Therefore, selection techniques and instruments are not a sure way to predict what people will do, even though they may have the ability to do it.

Testing itself, especially psychological testing, has limitations. Specifically, the seeking of certain information may be considered an invasion of privacy. In addition, it has been charged that some tests unfairly discriminate against women or members of minority groups. These complex issues are not easily resolved, yet they cannot be ignored when an enterprise is selecting managers.

Still other concerns in selection and hiring are the time and costs involved, including advertising, agency fees, tests, interviews, reference checks, medical examinations, relocation, orientation, and startup time required for the new manager to get acquainted with the job. When recruiting costs are recognized, it becomes evident that turnover can be very expensive to an enterprise.

**LEADERSHIP PERSPECTIVE[17]**

## HRM in India and Other Countries

Outsourcing has become very popular with globalization. India is often the favorite place. The benefits for outsourcing are obtaining a lower cost service which may increase the competitive advantage of the firm doing the outsourcing. Outsourcing, however, is not without risks because cultural differences may result in some difficulty in communication although English is widely spoken. Other considerations are the differences in time zones that may hinder, for example, providing assistance to Dell customers in the United States. On the other hand, communication through the internet is rather inexpensive. India, however, has no monopoly on the information technology and outsourcing. In Asia, the workforce in the Philippines also offers IT services and China is in the process of going into the IT business.

These developments have important implication for staffing and leading. Human resource managers have now a greater and more diverse pool for selecting suitable persons for the tasks. Traditional tools for selecting the right candidate may not be appropriate for candidates in other countries. Moreover, training and performance evaluation may have to be adapted to the local environment. Compensation, motivation, local needs, and requirements, as well as expectations differ among countries. Companies need to adapt to the local situation. This is true for India as well as other countries. ■■

## ORIENTING AND SOCIALIZING NEW EMPLOYEES

The selection of the best person for the job is only the first step in building an effective management team. Even companies that make great efforts in the recruitment and selection process often ignore the needs of new managers after they have been hired. Yet the first few days and weeks can be crucial for integrating the new person into the organization.

**Orientation** The introduction of new employees to the enterprise—its functions, tasks, and people.

**Orientation** involves the introduction of new employees to the enterprise—its functions, tasks, and people. Large firms usually have a formal orientation program that explains these features of the company: history, products and services, general policies and practices, organization (divisions, departments, and geographic locations), benefits (insurance, retirement, vacations), requirements for confidentiality and secrecy (especially with regard to defense contracts), as well as safety and other regulations. These may be further described in detail in a company booklet, but the orientation meeting provides new employees with an opportunity to ask questions. Although staff from the personnel department usually conducts these formal programs, the primary responsibility for orienting the new manager still rests with the superior.

LEADERSHIP PERSPECTIVE

### Leaders Create an Environment that People Enjoy[18]

www.southwest.com

www.ge.com

www.cisco.com

In the new millennium, companies are fiercely competing for talent in a very competitive job market. Losing a valuable employee may cost a company $50,000 to $100,000. How, then, can a company retain its intellectual capital?

Leaders such as Herb Kelleher at Southwest Airlines and Jack Welch at General Electric have done much to inspire their employees by providing an environment with challenging work and opportunities for personal and professional growth. Companies have pursued various strategies to retain employees. Firms with a good reputation, such as Southwest Airlines and General Electric, can highlight to their employees the competitive advantage of their firm and the opportunities in a growing organization. Companies in a market leadership position also have an advantage in retaining employees, as they can point out that leaving the company may be a step down. Other firms have created a feeling of community and family in their organization. Employees also like the flexibility of gaining different kinds of experience in various parts of the company. Empowerment through broad delegation gives employees decision-making authority and a sense of responsibility. Cisco Systems constantly makes its employees aware that they are welcomed. General Electric makes heavy investments in the best people through training and mentoring. Southwest Airlines pays much attention to finding the right people during the selection process by hiring people who fit the organization culture.

While companies face serious challenges in recruiting and retaining employees, people preparing for a career in management or as a staff person find a great opportunity in this situation. ■■

**Organizational socialization** Acquisition of work skills and abilities, adoption of appropriate role behaviors, and adjustment to the norms and values of the work group.

There is another and perhaps even more important aspect of orientation: the socialization of new managers. **Organizational socialization** is defined in several different ways. A global view includes three aspects: acquisition of work skills and abilities, adoption of appropriate role behaviors, and adjustment to the norms and values of the work group. So, in addition to meeting the specific requirements of the job, new managers will usually encounter new values, new personal relationships, and new modes of behavior. They do not know whom they can ask for advice, they do not know how the organization works, and they have a fear of failing in the new job. All this uncertainty can cause a great deal of anxiety for a new employee, especially a management trainee. Because the initial experience in an enterprise can be very important for future management behavior, the first contact of trainees should be with the best superiors in the enterprise, people who can serve as models for future behavior.

## MANAGING HUMAN RESOURCES WHILE MOVING TOWARD 2020[19]

The future is difficult to predict; yet managers do have to make decisions now to prepare for the future. The Economist Intelligence Unit surveyed some 1,650 executives from around the world asking how they see changes while moving toward the year 2020. The areas which have the greatest potential for improving productivity are managing knowledge, providing services and support to customers, improving operations and production processes, developing businesses and strategies, managing marketing and sales activities, managing human resources and training, as well as other areas. These views of executives do have important implications for human resource management.

The contributions of knowledge workers may be most critical for gaining a competitive advantage. Moreover, collaboration within the organization as well as with the outside will be very important. This, of course, requires people with good interpersonal relationships. They need to be able to operate in different cultural environments and communicate well. The staffing functions of recruitment, selection, training, and development will play important roles in preparing for the future. Similarly, effective leading, motivation, and communication, and functions discussed in Part 5 in this book will be essential to compete in the global environment.

**LEADERSHIP PERSPECTIVE**

### The Future of Work[20]

Globalization and technology are changing our jobs. It is, of course, difficult to predict the future but some of the trends can already be seen in companies. The new CEO may be a global networker. Although organization structure will still be needed, the cubical culture will be reduced or eliminated. This means the office boundaries will be removed and offices and office desks will become less important or even disappear. The workforce will be more multicultural that is it now. Wellness

programs will aim to keep the workers healthy and employees may choose from a variety of benefits ("cafeteria" approach). Projects will be multidisciplinary with a scalable workforce to adjust to the work demands. In some ways, the future is already here. ■■

## SUMMARY

Staffing means filling positions in the organization structure. It involves identifying workforce requirements, inventorying the people available, and recruiting, selecting, placing, promoting, appraising, planning the careers of, compensating, and training people.

In the systems approach to staffing, enterprise and organization plans become important inputs for staffing tasks. The number and quality of managers required to carry out crucial tasks depend on many different factors. One major step in staffing is to determine the people available by making a management inventory, which can be done in the form of an inventory chart.

Staffing does not take place in a vacuum; one must consider many situational factors, both internal and external. Staffing requires adherence to equal employment opportunity laws so that practices do not discriminate, for example, against minorities or women. Also, one must evaluate the pros and cons of promoting people from within the organization or selecting people from the outside.

In the systems model for selection, the comprehensive managerial requirements plan is the basis for position requirements. In designing jobs, the enterprise must see that the job has an appropriate scope, is challenging, and reflects required skills. The job structure must be appropriate in terms of content, function, and relationships. Jobs can be designed for individuals or work teams. The importance of technical, human, conceptual, and design skills varies with the level in the organizational hierarchy. The position requirements have to be matched with the various skills and personal characteristics of individuals. The matching is important in recruitment, selection, placement, and promotion.

Errors in selection can lead to actualization of the Peter Principle, which states that managers tend to be promoted to the level of their incompetence. Although the advice of several people should be sought, the selection decision should generally rest with the immediate superior of the candidate for the position.

The selection process may include interviews, various tests, and the use of assessment centers. To avoid dissatisfaction and employee turnover, companies must ensure that new employees are introduced to and integrated with other persons in the organization.



## KEY IDEAS AND CONCEPTS FOR REVIEW

- ✔ Staffing
- ✔ Systems approach to human resource management
- ✔ Management inventory
- ✔ Situational factors affecting staffing
- ✔ Equal employment opportunity
- ✔ Women in management

- ✔ Diversity in the workplace
- ✔ Staffing in the international environment
- ✔ Promotion from within
- ✔ Policy of open competition
- ✔ Systems approach to selection
- ✔ Position and job requirements
- ✔ Job design
- ✔ Recruitment
- ✔ Selection
- ✔ Placement
- ✔ Promotion
- ✔ Peter Principle
- ✔ Validity and reliability
- ✔ Selection process
- ✔ Interview
- ✔ Kinds of tests
- ✔ Assessment center
- ✔ Orientation and socialization
- ✔ The future of managing human resources

## FOR DISCUSSION

1. Why is the function of staffing seldom approached logically? Briefly describe the systems approach to staffing. How is staffing related to other managerial functions and activities?
2. List and evaluate external factors affecting staffing. Which ones are most critical today? Explain.
3. What are the dangers and difficulties in applying a policy of promotion from within? What is meant by a policy of open competition? Do you favor such a policy? Why or why not?
4. What is the systems approach to selection of managers? Why is it called a systems approach? How does it differ from other approaches?
5. What are some of the factors that are important in designing individual jobs and jobs for work teams? Which ones seem most important to you? Why?
6. The Peter Principle has been widely quoted in management circles. What do you think of it? Do you think that it could ever apply to you? Does it mean that all chief executives are incompetent? Explain.
7. What is an assessment center? How does it work? Would you like to participate in such a center? Why or why not?

## EXERCISES/ACTION STEPS

1. Select an organization that you know and evaluate the effectiveness of its recruitment and selection of people. How systematically are these and other staffing activities carried out?
2. Go to the library and research the background of successful CEOs. You may begin by looking at *Fortune* magazine or reading the biography of a CEO. What makes the CEOs successful?

## INTERNET RESEARCH

1. Use one of the popular search engines to search for "workforce.com." What are some of the current topics human resource managers are concerned about?
2. What does equal employment opportunity mean? Search the Web and then select a topic to present to the class.

## International Case Recruiting Talents at Infosys[21]

Infosys, founded in 1981 in Pune by N. R. Narayana Murthy and his colleagues, is one of the biggest IT (Information Technology) companies in India. Two years later, the firm moved its headquarters to Bangalore. In 1987, Infosys began its international expansion by opening its first sales office in Boston. By 2008, the company with more than 90,000 employees (mostly professionals) had expanded its operation to more than 30 offices worldwide. How does one recruit competent people for this global organization?

Operating in the software industry, Infosys provides services to many businesses in a variety of industry segments including banking, communication media, entertainment, manufacturing, energy and utilities, retail businesses, consumer products and services, and many others.

In 1996, the company created a foundation, headed by Mrs. Sudha Murthy, that works in a variety of areas such has healthcare, arts, culture, social activities, and education. Some of the initiatives include a program called Academic Entente that involves activities such as arranging academic conferences, research collaboration, a global internship program, and study tours to the company's development center. This initiative provides the link to academic institutions. The global internship program also provides opportunities for recruiting undergraduates, graduates as well as Ph.D. students. The disciplines are not restricted to business students, but also include liberal arts majors. Such programs aim at getting young people interested in information technology and computer science.

The $120 million Global Education Center in Mysore, about 90 miles from Bangalore, is one of the largest company training centers. It has been said that it is more difficult to be admitted to the Infosys training program than to get into Harvard. Only one percent of applicants get invited to the campus which is like a modern university; it also includes a large gym, a swimming pool, a bowling alley, and even a hair salon. The campus, however, is run by strict rules such as alcohol prohibition. Yet, the "freshers" as the new recruits are called, do not complain—indeed it is considered a dream come true to be invited to the program which not only focuses on technical skills, but also includes communication and team building classes. The participants come from many countries and the aim is to train some 10,000 employees at a time.

**Questions**

1. People are the key to success of enterprises. Address the recruitment efforts for finding and recruiting talents at Infosys.
2. Would you be interested in working for Infosys operating in many diverse businesses or would you prefer to become an entrepreneur working for a relative or establishing your own business?
3. List the advantages and disadvantages in working for a company like Infosys or being an entrepreneur.

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# 12 Performance Appraisal and Career Strategy

## CHAPTER OBJECTIVES

After studying this chapter, you should be able to:

- Recognize the importance of effectively appraising managers
- Identify the qualities that should be measured in appraising managers
- Present a system of managerial appraisal based on evaluating performance against verifiable objectives and performance as a manager
- Describe the team approach to evaluation
- Recognize the rewards and stress of managing
- Identify important aspects of career planning

Managerial appraisal has sometimes been referred to as the Achilles' heel of managerial staffing, but is a major key to managing itself. It is the basis for determining who is promotable to a higher position. It is also important to management development because it is difficult to determine whether development efforts are aimed in the right direction if a manager's strengths and weaknesses are not known. Appraisal is, or should be, an integral part of a system of managing. Knowing how well a manager plans, organizes, staffs, leads, and controls is really the only way to ensure that those occupying managerial positions are actually managing effectively. If a business, a government agency, a charitable organization, or even a university is to reach its goals effectively and efficiently, ways of accurately measuring management performance must be found and implemented.

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There are other reasons why effective managerial appraisal is important. One of the most compelling in the United States arises from the provisions of Title VII of the Civil Rights Act of 1964 (as amended in 1972) and the regulations of the Equal Employment Opportunity Commission and the Office of Federal Contract Compliance. These agencies have been highly critical of many appraisal programs, finding that they often result in discrimination, particularly in areas of race, age, and sex. Courts have supported the federal agencies in their insistence that, to be acceptable, an appraisal program must be reliable and valid. That these agencies set rigorous standards is apparent.

Effective performance appraisal should also recognize the legitimate desire of employees for progress in their professions. One way to integrate organizational demands and individual needs is through career management, which can be a part of performance appraisal, as this chapter will explain.

## CHOOSING APPRAISAL CRITERIA

The appraisal should measure performance in accomplishing goals and plans as well as performance as a manager. No one wants a person in a managerial role who appears to do everything right as a manager but who cannot turn in a good record of profit making, marketing, controllership, or whatever the area of responsibility may be. Nor should one be satisfied to have a "performer" in a managerial position who cannot operate effectively as a manager. Some star performers may have succeeded by chance and not through effective managing.

### Performance in Accomplishing Goals

In assessing performance, systems of appraising against verifiable pre-selected goals have extraordinary value. Given consistent, integrated, and understood planning designed to reach specific objectives, probably the best criteria of managerial performance relate to the ability to set goals intelligently, to plan programs that will accomplish those goals, and to succeed in achieving them. Those who have operated under some variation of this system often claim that these criteria are inadequate and that elements of luck or other factors beyond the manager's control are not excluded when arriving at any appraisal. In too many cases, managers who achieve results owing to sheer luck are promoted, and those who do not achieve the expected results because of factors beyond their control are blamed for failures. Thus, appraisal against verifiable objectives is, by itself, insufficient.



### Performance as Managers

The system of measuring performance against pre-established objectives should be supplemented by an appraisal of the manager as a manager.

The system of measuring performance against pre-established objectives should be supplemented by an appraisal of the manager as a manager. Managers at any level also undertake nonmanagerial duties, and these cannot be overlooked. However, the primary purpose for which managers are hired and against which they should be measured is their performance as managers, which means they should be appraised on the basis of how well they understand and undertake the managerial functions of planning, organizing, staffing, leading, and controlling. The standards to use in this area are the fundamentals of management; but, first, appraising against performance objectives should be examined.

A network of meaningful and attainable objectives is basic to effective managing.

## APPRAISING MANAGERS AGAINST VERIFIABLE OBJECTIVES

One widely used approach to managerial appraisal is the system of evaluating managerial performance against the setting and accomplishing of verifiable objectives. As

was noted in Chapter 4, a network of meaningful and attainable objectives is basic to effective managing. This is simple logic, since people cannot be expected to accomplish a task with effectiveness or efficiency unless they know what the end points of their efforts should be. Nor can any organized enterprise be expected to do so.

## The Appraisal Process

Once a program of managing by verifiable objectives is operating, appraisal is a fairly easy step. Superiors determine how well managers set objectives and how well they have performed against them. In cases where appraisal by results has failed or has been disillusioning, the principal reason is that managing by objectives was seen only as an appraisal technique. The system is not likely to work if used only for this purpose. Management by objectives must be a way of managing, a way of planning, as well as the key to organizing, staffing, leading, and controlling. When this is the case, appraisal boils down to whether managers have established adequate and reasonably attainable objectives and how they have performed against them in a certain period. Look at the systems approach to management by objectives in Figure 4.4 in Chapter 4. As the figure shows, appraising is merely a last step in the entire process.

There are other questions to consider too. Were the goals adequate? Did they call for "stretched" (high but reasonable) performance? These questions can be answered only through the judgment and experience of a person's superior, although this judgment can become sharper with time and experience, and it may be even more objective if the superior can use the goals of other managers in similar positions for comparison.

In assessing the accomplishment of goals, the evaluator must take into account such considerations as whether the goals were reasonably attainable in the first place, whether factors beyond a person's control unduly helped or hindered the person in accomplishing goals, and what the reasons for the results were. The reviewer should also note whether an individual continued to operate against obsolete goals when situations changed and revised goals were called for.

## Different Views on Appraisal Issues

People hold different views on performance appraisal issues. We will focus on three of them.

**Subjective versus objective evaluation** There are those who still maintain that subjective rating of subordinates is sufficient. After all, it is argued, managerial performance is difficult to evaluate. On the other side of the argument are those who maintain that an appraisal must be completely objective and only numbers count; either a person achieves the previously set objective or not.

Appraisal should focus on results, but one must be careful to avoid the "numbers game."

Appraisal should focus on results, but one must be careful to avoid the "numbers game." Figures can be manipulated to suit the individual, thus defeating the purpose of appraisal. Also, pursuing a limited number of verifiable criteria may ignore other, not formally stated objectives, as one cannot set objectives for all tasks. It is, therefore, not only important to look at performance figures but also at the causes of positive or negative deviations from standards, although this may involve some subjective judgment.

**Judging versus self-appraisal** There is the view that managers have the authority vested in their position, and therefore they should be the sole judge in assessing the performance of their subordinates. But many managers dislike being placed in the role of a judge, especially when they are asked to evaluate subordinates on personality characteristics. Similarly, employees feel uncomfortable being judged on factors that have questionable relationships to the tasks they are doing. The other view holds that people should be asked to appraise themselves. It is realized that some subordinates may be harsher on themselves than their superior would be; but other individuals may rate themselves unreasonably high, especially if the rating influences their salary.

The management-by-objectives philosophy places emphasis on self-control and self-direction.

The management-by-objectives philosophy places emphasis on self-control and self-direction. But this presupposes that verifiable objectives have been previously set (primarily by the subordinate in conjunction with the superior), against which performance can be measured. Indeed, if this is done well, appraising is relatively easy. There should be no surprises during the appraisal meeting: subordinates know what they want to achieve and superiors know what contributions they can expect from their subordinates. Besides the comprehensive appraisal, periodic and constant monitoring of performance can uncover deviations from standards. Generally, then, subordinates should have an opportunity to exercise self-control, but the superior still has the veto power in case of controversy about the objective that is the basis for performance appraisal.

One should learn from past mistakes and translate these insights into development plans for the future.

**Assessing past performance versus future development** Some managers see the purpose of appraisal primarily as assessing past performance, but others focus on the developmental aspects of appraisal. The improvement orientation in the latter is toward the future.[1]

With the emphasis on self-appraisal and responsible self-direction, the judgmental aspect in appraisal is considerably reduced. To be sure, one should learn from past mistakes, but one should use these insights for translating them into development plans for the future. Clearly, appraisal can be an excellent opportunity to emphasize a person's strengths and to prepare action plans for overcoming weaknesses, as discussed in the career planning section later in this chapter.



The formal comprehensive appraisal should be conducted at least once a year, with discussions taking place more frequently. It should be supplemented by frequent progress or periodic reviews as well as continuous monitoring.

## Three Kinds of Reviews

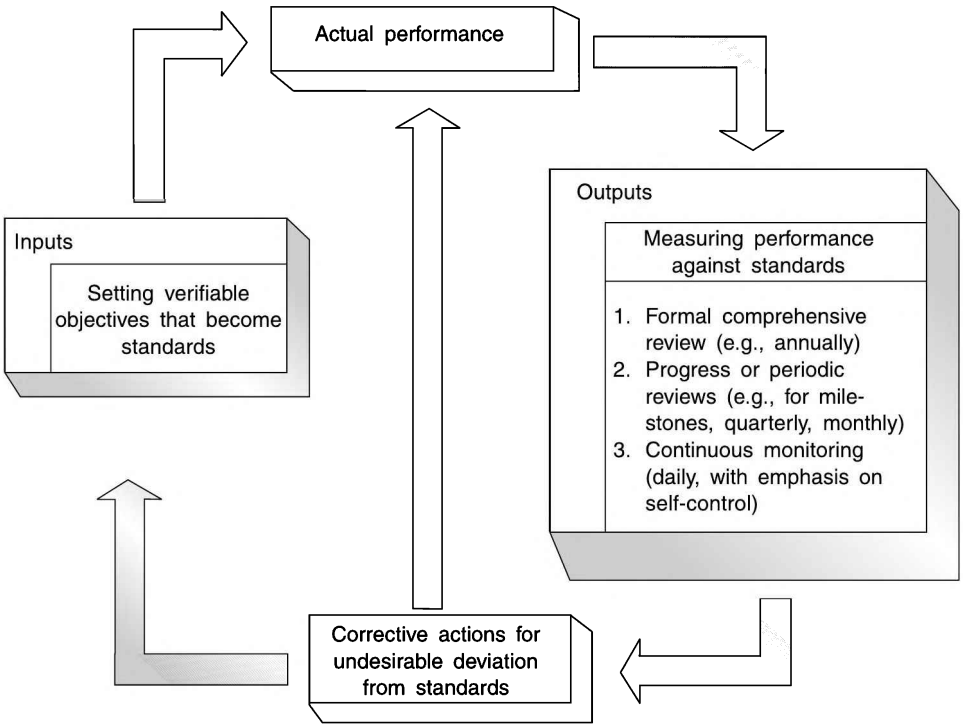
The simplified model of performance appraisal shown in Figure 12.1 indicates three kinds of appraisals: (1) a comprehensive review, (2) progress or periodic reviews, and (3) continuous monitoring.

There is general agreement that a *formal comprehensive appraisal* should be conducted at least once a year, but some people suggest that such discussions should take place more frequently. Some enterprises do all the reviews within a short period of time each year, while others schedule the appraisals throughout the year, often at the employment anniversary. A case could be made against any rigid schedule of annual performance reviews. Instead, it may be argued with good reason that performance should be reviewed, for example, after the completion of a major project. Obviously, no universally applicable suggestion can be made about the time frame

**Figure 12.1**

**The Appraisal Process.**

**Redrawn from Heinz Weihrich, *Management Excellence: Productivity through MBO* (New York: McGraw-Hill, 1985), p. 125.**




for the formal comprehensive review. It depends on the nature of the task, past company practices, and other situational factors. Once, twice, or even three times may be appropriate for a particular organization or a person who is new in a job.

What is important is that the formal comprehensive review should be supplemented by frequent *progress or periodic reviews*. These reviews can be short and relatively informal, but they help identify problems or barriers that hinder effective performance. They also keep communication open between the superior and the subordinates. Furthermore, priorities can be rearranged and objectives can be renegotiated if warranted by changed situations. It certainly is inappropriate to pursue obsolete or even unsuitable objectives that were agreed upon in an environment of uncertainties.

Finally, there is *continuous monitoring* of performance. With this system, when performance deviates from plans, one does not have to wait for the next periodic review to correct it. The superior and the subordinate discuss the situation immediately so that corrective actions can be taken at once in order to prevent a small deviation from developing into a major problem.

## Strengths of Appraisal against Verifiable Objectives

The strengths of appraising against accomplishment of objectives are almost the same as those of managing by objectives. Both are parts of the same process, both are basic to effective managing, and both are means of improving the quality of managing.

In the area of appraising, there are other special and important strengths. Appraising on the basis of performance against verifiable objectives has the great advantage of being operational. Appraisals are not apart from the job that managers do, but are a review of what they actually did as managers.

There are always questions of how well a person did; of whether goals were missed or accomplished, and for what reasons; and of how much in the way of goal attainment should be expected. But information about what a person has done, measured against what that individual agreed was a reasonable target, is available. This information furnishes strong presumptions of objectivity and reduces the element of pure judgment in appraisal. Besides, the appraisal can be carried on in an atmosphere in which superiors work in cooperation with subordinates rather than sitting in judgment with them.

## Weaknesses of Appraisal against Verifiable Objectives

As noted in Chapter 4, there are certain weaknesses in the implementation of managing by objectives. These apply with equal force to appraisal. One of them is that it is entirely possible for persons to meet or miss goals through no effort or fault of their own. Luck often plays a part in performance. A new product's acceptance may be far beyond expectations, and its success will make a marketing manager look exceptionally good, even though the quality of the marketing program and its implementation might actually be poor. Or an unpredictable cancellation of a major military contract might make the record of a division manager look unsatisfactory. There may also be an overemphasis on output quantity and not enough attention given to the quality of the product or service.[2]

Most evaluators will say that they always take uncontrollable or unexpected factors into account in assessing goal performance, and to a very great extent they do. But it is extremely difficult to do so. In an outstanding sales record, for example, how can anyone be sure how much was due to luck and how much due to competence? Outstanding performers are rated highly, at least as long as they perform. Nonperformers can hardly escape having a cloud cast over them.

With its emphasis on accomplishing operating objectives, the system of appraising against these may overlook needs for individual development. Goal attainment tends to be short-run in practice. Even if longer-range goals are put into the system, seldom are they so long-range as to allow for adequate long-term development of managers. Managers concerned primarily with results might be driven by the system to take too little time to plan, implement, and follow through with programs required for their development and that of their subordinates.

On the other hand, since managing by objectives gives better visibility to managerial needs, development programs can be better pinpointed. If individual development is to be ensured, goals in this area should be specifically set.

From an appraisal as well as an operating management point of view, perhaps the greatest deficiency of management by objectives is that it appraises operating performance only. Not only is there the question of luck, but also there are other factors to appraise, notably an individual's managerial abilities. This is why an adequate appraisal system must appraise performance as a manager as well as performance in setting and meeting goals.

**INTERNATIONAL PERSPECTIVE**

### How About a Twitter Performance Evaluation?[3]

Twitter is a social networking program that is limited by 140 words communication. In the Twitter and Facebook age, people want immediate feedback. However, traditional performance reviews are mostly done once or twice a year. Accenture has developed a Facebook-type program "Performance Multiplier." People post two or three weekly goals, project status updates, and even include photos. Another program, called "Ripple" lets people post up to 140 words questions requesting anonymous feedback. This allows people to post questions, for example, about the assessment of a presentation or how to conduct a more effective meeting. Posting goals and updating them from time to time keeps others informed. Supervisors can note the progress of their employees and also identify those who do not post their objectives. This approach seems to be congruent with the MBO approach which requires stating objective clearly, updating not only the superior but also the colleagues about the progress toward the goals. At this time, this 140 Twitter key strokes approach may not be widely used, but it is an alternative, or rather a supplement, to the dreaded yearly performance evaluation. ■■

## APPRAISING MANAGERS AS MANAGERS: A SUGGESTED PROGRAM

The most appropriate standards to use for appraising managers as managers are the fundamentals of management.

The most appropriate standards to use for appraising managers as managers are the fundamentals of management. It is not enough to appraise a manager broadly, evaluating only performance of the basic functions of the manager; appraisal should go further.

The best approach is to utilize the basic techniques and principles of management as standards. If they are basic, as they have been found to be in a wide variety of managerial positions and environments, they should serve as reasonably good standards. As crude as they may be, and even though some judgment may be necessary in applying them to practice, they give the evaluator some benchmarks for measuring how well subordinates understand and are following the functions of managing. They are definitely more specific and more applicable for evaluation than such broad standards as work and dress habits, cooperation, intelligence, judgment, and loyalty. They at least focus attention on what may be expected of a manager as a manager. And when used in conjunction with appraisal of the performance of plans and goals, they can help remove much of the weakness in many management appraisal systems.

In brief, the appraisal program that we suggest involves classifying the functions of the manager as done in this book and then dealing with each function by a series of questions. The questions are designed to reflect the most important fundamentals of managing in each area. Although the whole list of 73 key questions, the form used, the system of ratings, and the instructions for operating the program are too extensive to be treated in this book, sample "checkpoints" in the areas of planning and organizing are presented in Table 12.1.

**Table 12.1** Sample Questions for Appraising Managers as Managers

| *Planning* |
|---|
| • Does the manager set for the department both short- and long-term goals in verifiable terms that are related in a positive way to those of the superiors and of the company? |
| • In choosing from among alternatives, does the manager recognize and give primary attention to those factors that are limiting or critical to the solution of a problem? |
| • Does the manager check plans periodically to see if they are still consistent with current expectations? |
| *Organizing* |
| • Does the manager delegate authority to subordinates on the basis of results expected of them? |
| • Does the manager refrain from making decisions in that area once authority has been delegated to subordinates? |
| • Does the manager regularly teach subordinates, or otherwise make sure that they understand, the nature of line and staff relationships? |

*Source:* Harold Koontz and Heinz Weihrich, *Measuring Managers: A Double-barreled Approach* (New York: AMACOM, 1981).



Semantics has always been a problem in management. Therefore, it is wise to use a standard book on management (such as this one) and refer to the pages that correspond to the questions. This approach leads to a fair degree of managerial development.

Managers are rated on how well they perform the activities. The scale used is from 0 for "inadequate" to 5 for "superior." To give the numerical ratings more rigor, each rating is defined. For example, "superior" means "a standard of performance which could not be improved under any circumstances or conditions known to the rater."

To further reduce subjectivity and to increase the discrimination between performance levels, the program requires that (1) in the comprehensive annual appraisal, incident examples be given to support certain ratings; (2) the ratings be reviewed by the superior's superior; and (3) the raters be informed that their own appraisal will depend in part on how well they discriminate on the ratings of performance levels when evaluating their subordinates. Obviously, objectivity is enhanced by the number and the specificity of the checkpoint questions.

## Advantages of the Program

Experience with this program in a multinational company showed certain advantages. By focusing on the essentials of management, this method of evaluation gives operational meaning to what management really is. Also, the use of a standard reference text for interpretation of concepts and terms removes many of the semantic and communication difficulties so commonly encountered. Such things as variable budgets, verifiable objectives, staff, functional authority, and delegation take on consistent meaning. Likewise, many management techniques become uniformly understood.

The system, furthermore, has proved to be a tool for management development. In many cases, it has brought to managers' attention certain basics that they may have long disregarded or not understood. In addition, it has been found useful in pinpointing areas in which weaknesses exist and to which development should be directed. Finally, as intended, the program acts as a supplement to, and a check on appraisal of managers' effectiveness in setting and achieving goals. If a manager has a record of outstanding performance in goal accomplishment but is found to be a less-than-average manager, those in charge will look for the reason. Normally, one would expect a truly effective manager to be effective also in meeting goals.

## Weaknesses of the Program

There are, however, a number of weaknesses or shortcomings in the approach. It applies only to managerial aspects of a given position and not to such technical qualifications as marketing or engineering abilities that might also be important. These, however, can be weighed on the basis of goals selected and achieved. There is also the apparent complexity of 73 checkpoints; rating on all of them does take time, but the time is well spent.

Perhaps the major shortcoming in appraising managers as managers is the subjectivity involved. Some subjectivity in rating each checkpoint is unavoidable. However, the program still has a high degree of objectivity and is far more objective than appraisal of managers only on the broader areas of the managerial functions. At least the checkpoints are specific and pertain to the essentials of managing.

# A TEAM EVALUATION APPROACH[4]

Another approach to performance appraisal has been introduced. The criteria selected for evaluation are in part similar to the ones mentioned above and include planning, decision-making, organizing, coordinating, staffing, motivating, and controlling. But other factors, such as selling skills, may also be included.

The appraisal process involves the person being evaluated and consists of the following steps:

- Selection of job-related criteria
- Development of examples of observable behavior
- Selection of four to eight raters (peers, associates, other supervisors, and naturally the immediate superior)

- Preparation of the rating forms applicable to the job
- Completion of the forms by the raters
- Integration of the various ratings
- Analysis of the results and preparation of the report

This approach has been used not only for appraisal but also for the selection of people for promotion and for personnel development, and even for dealing with alcoholism.

The advantages suggested by the originators of this approach include a rather high degree of accuracy in appraising people by obtaining several inputs rather than input from the superior only. The program can be used to identify raters' bias (e.g., rating consistently high or low, or giving such ratings to certain groups of people, such as women or people of minority groups). The persons being rated apparently would consider this approach quite fair, since they are involved in selecting the evaluation criteria as well as the raters. It also allows comparison of individuals with each other. Although this approach has been used by a variety of enterprises, further assessment seems necessary.

## APPLICATION OF PERFORMANCE REVIEW SOFTWARE[5]

The annual review of performance is often disliked by both the superior and the subordinate. Moreover, it is time consuming. One study at Cornell University found that in large firms, managers spend about six hours per year for each employee.[6] More recently, several companies developed software that may make the evaluations among superiors more consistent by providing a structure to the appraisal. The paper-based evaluation may be replaced or complemented with web-based appraisal. Of course, the computer-based program is no substitute for the human interaction between the superior and subordinate. However, the software may include a number of valuable features.

A manager may complete electronically the evaluation form that can be reviewed by other managers who can provide additional inputs and by the employee himself or herself before it is submitted to the human resource department. The database can then be used for identifying training needs, management development, and for identifying those individuals who are ready for promotions to a position within the total organization.

Managers, who do not submit the evaluations of their employees in time, can be reminded automatically through the software program. This increases the on-time completion of appraisals. While it is not a cure-all to the often much dreaded annual appraisal, it can save time and make this important task easier.

## REWARDS AND STRESS OF MANAGING

Managers are different: they have different needs, desires, and motives. The essentials of motivation will be discussed in Chapter 14; the concern here is with some of the general and financial rewards as well as the stressful aspects of managing.

## Rewards of Managing: General Aspects

Since managerial candidates differ widely in age, economic position, and level of maturity, their needs and wants vary, but they usually include opportunity, power, and income. Most managerial candidates desire the opportunity for a progressive career that provides depth and breadth of managerial experience. Related to this is the challenge found in meaningful work. Most people, but perhaps managers in particular, want to feel that they have the power to make a significant contribution to the aims of an enterprise and even to society.

In addition, managers want to be, and should be, rewarded for their contributions, although the size of financial rewards has been criticized.

## Pay for Performance

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There is probably no other item as controversial as the relationship between appraisal of performance and pay. At General Electric (GE), workers get paid for performance: they are paid bonuses when they achieve challenging goals instead of according to a person's title or the length of service. Such an approach requires that the goals be clear and people know what is expected of them. Also, it must be explained to employees what the total compensation is, including fringe benefits. At one university, for example, faculty members get a benefit statement that shows not only the annual salary but also the university's contribution to the health plan, the faculty assistance program, life insurance, dental insurance, long-term disability insurance, worker's compensation, travel accident insurance, Social Security tax, and the university's retirement contribution.

www.gemedical-systems.com

The reward should be timely. This means that it should be given shortly after the work well done. The GE Medical Systems group, for example, has a Quick Thanks program that lets employees nominate a colleague for an exceptional performance. The $25 gift certificate can be used in selected stores and restaurants. The positive psychological effect may be even more important than the monetary reward.

An increase in salary can hardly ever be reversed. A bonus, on the other hand, can be made contingent on outstanding performance. Steven Kerr at GE recommends variable compensation based on performance, but he also recognizes that this may not be suitable in some countries. A cash bonus could be considered a bribe in Japan because it may be seen as paying for work that is a part of the job anyway. Also, some employees may prefer an extra vacation instead of a cash payment. Therefore, cultural differences should be taken into account when using variable compensation.

**INTERNATIONAL PERSPECTIVE**

### Pay for Performance at Lincoln Electric[7]

www.lincolnelectric.com

Lincoln Electric's incentive plan has been the model for other companies for years. Yet even its successful pay-for-performance system is beginning to change.

The family-controlled company, making welding equipment and supplies, has been known for its unique compensation system. Its 3,400 employees are paid for work, with no pay for holidays or sick leave; they are considered self-managing entrepreneurs. Twice a year, they are held accountable for their output, quality, cooperation, dependability, and ideas. Their average hourly pay is only slightly above the average manufacturing wage in the area around Cleveland, but their bonuses averaged 56 percent of annual wages in 1995. Substantial? Yes, but lower than in some previous years. Because of the bonuses, the pay differential among workers is substantial, ranging from about $32,000 to more than $100,000.

The pressure to perform is great. Yet the turnover rate is less than 4 percent among those who survived at least the first 180 days in the company. When Lincoln Electric lost money in 1992 and 1993 because of an unwise foreign acquisition, it borrowed money to pay bonuses to its workers.

But things began to change somewhat when the company made public offerings in 1996 so that outsiders gained a 40 percent stake in the firm. While the unique bonus system is to remain, the bonuses may be reduced. With global competition, the company expects to modernize its facilities, expand abroad, and recruit more outsiders. ■■

Should doctors be paid for performance? This is the big question for 80 physicians with specialties in psychiatry, neurology, general pediatrics, as well as adolescent and emergency medicine at the Children's Hospital in Oakland, California.[8] The proposed plan would provide bonuses for the doctors instead of being paid for the time they worked. Although the performance criteria are not quite clear, they might include the number of visits and other factors. Most of the physicians are opposed to the plan arguing that the incentive plan would result that doctors would spend less time with each patient, give greater attention to private-pay patients and less to those covered by Medi-Cal. While pay-for-performance is generally accepted in companies, the concept may be more difficult to apply in certain fields such as medical care.



## Stress in Managing[9]

**Stress** An adaptive response, mediated by individual differences and/or psychological processes, which are a consequence of any external action, situation, or event that places excessive psychological and/or physical demands on a person.

**Stress** is a very complex phenomenon. It is, therefore, no surprise that there is no commonly accepted definition. A widely used working definition is an adaptive response, mediated by individual differences and/or psychological processes, that is a consequence of any external (environmental) action, situation, or event that places excessive psychological and/or physical demands on a person.

Hans Selye, probably the leading authority on the concept of stress, describes stress as "the rate of all wear and tear caused by life."[10] There are many physical sources of stress, such as work overload, irregular work hours, loss of sleep, loud noises, bright light, and insufficient light. Psychological sources of stress may be due to a particular situation, such as a boring job, inability to socialize, lack of autonomy, responsibility for results without sufficient authority, unrealistic objectives, role ambiguity or role conflict, or a dual-career marriage. But what might be stressful to one person may be less so to another; people react differently to situations.

Stress can have various effects on the individual as well as on the organization.[11] There are the physiological effects that may be linked to a variety of illnesses. Then there are psychological effects such as burnout or boredom. Various kinds of behavior, such as drug and alcohol abuse, inordinate food consumption, accidents, or withdrawal from the stressful situation (absenteeism, excessive labor turnover), may be a reaction to stress. Clearly, not only does the individual suffer, but the organization may also be affected by the turnover or impaired decision-making of its managers and nonmanagers alike.

Individuals and organizations have attempted to deal with stress in various ways. Individuals may try to reduce stress through better time management, healthful nutrition, exercise, career planning, a change in jobs, promotion of psychological health, relaxation, meditation, and prayer. Organizations may provide counseling or recreation facilities or may improve the job design by matching the person with the job.

## Fitting the Needs of the Individual to the Demands of the Job

Managing, then, offers rewards but also involves stress. An individual aspiring to a managerial position should evaluate both the advantages and the disadvantages of managing before pursuing this career. A proper fit between individual needs and the demands of the task will benefit both the individual and the enterprise. Career management will help to achieve this fit.

**LEADERSHIP PERSPECTIVE**

### How to Lead the Generation Xers?[12]

Baby boomers often lead Generation Xers. What are the implications for staffing and leading? The term "Baby Boomers" refers to people born after World War II, generally in the middle of the 20th century; let's say about from 1945 to 1964. The term *Generation X* was introduced in the early 1950s by Robert Capa and generally refers to the people born in the 1960s ending in the late 1970s to early 1980s. The time frames are, of course, approximate. The Generation Xers grew up in an environment of computers, cell phones, Facebook, Twitter, cloud computing, and other technological application. It was also a rather uncertain environment characterized by corporate downsizing and job changers. Generation Xers are often led by baby boomers. Managing the Generation Xers has implications for staffing and leading. This is what some experts suggest for leading the Xers:

- Give them challenging assignments so that they can use their entrepreneurial talents
- Let them work in teams
- Involve them in planning
- Give reasons for instructions
- Give them feedback on their performance promptly
- Provide counseling for their career path

These suggestions, of course, should be also considered for leading older employees, but they may be especially important for the Generation Xers. ■■

## FORMULATING THE CAREER STRATEGY[13]

The appraisal of performance should identify the strengths and weaknesses of an individual; this identification can be the starting point for a career plan. The personal strategy should be designed to utilize strengths and overcome weaknesses in order to take advantage of career opportunities. Although there are different approaches to career development,[14] it is considered here as a process of developing a personal strategy that is conceptually similar to an organizational strategy. This process is summarized in Figure 12.2 and elaborated next.

### 1. Preparation of a Personal Profile

One of the most difficult tasks is gaining insight into oneself, yet this is an essential first step in developing a career strategy. Managers should ask themselves: Am I an introvert or an extrovert? What are my attitudes toward time, achievement, work, material things, and change? The answers to these and similar questions and a clarification of values will help in determining the direction of the professional career.

### 2. Development of Long-Range Personal and Professional Goals



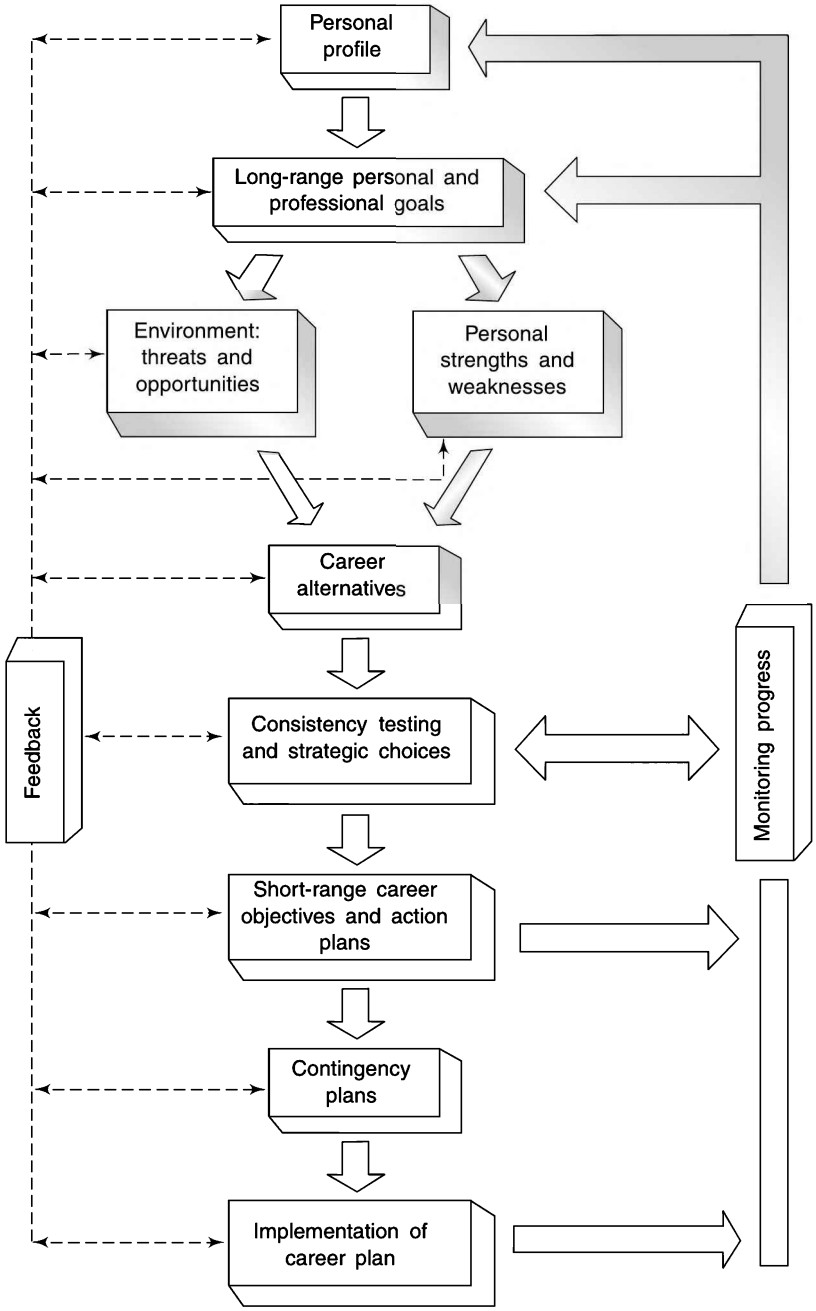
No airplane would take off without a flight plan including a destination. Yet how clear are managers about the direction of their lives? People often resist career planning because it involves making decisions. By choosing one goal, a person gives up opportunities to pursue others; if an individual studies to become a lawyer, he or she cannot become a doctor at the same time. Managers also resist goal setting because uncertainties in the environment cause concern about making commitments. Furthermore, there is the fear of failing to achieve goals because failure is a blow to one's ego.

But by understanding the factors that inhibit goal setting, one can take steps to increase commitment. First, when the setting of performance goals becomes a part of the appraisal process, identifying career goals is easier. Besides, one does not set career goals all at once. Rather, goal setting is a continuing process that allows flexibility; professional goals can be revised in light of changing circumstances. Another factor that reduces resistance to goal setting is the integration of long-term aims with the more immediate requirement for action. For example, the aim of becoming a doctor makes one accept the study of boring subjects that are necessary for the medical degree.

How far in advance should one plan? The answer may be found in the commitment principle. It states that planning should cover a period of time necessary for the fulfillment of commitments involved in the decision made today. Therefore, the time frame for career planning will differ with the circumstances. For example, if a person wants to become a professor, it is necessary to plan for university studies of

**Figure 12.2**

**Formulation of a Career Strategy.**



seven to nine years. On the other hand, if the career goal is to become a taxi driver, the time span is much shorter. At any rate, the long-term aim has to be translated into short-term objectives. Before this is done, it is necessary to make a careful assessment of the environment, including its threats and opportunities.

## 3. Analysis of the Environment: Threats and Opportunities

In the analysis of the environment, internal and external, many diverse factors need to be taken into account. They include economic, social, political, technological, and demographic factors; they also include the labor market, competition, and other factors relevant to a particular situation. For example, joining an expanding company usually provides more career opportunities than working for a mature company that is not expected to grow. Similarly, working for a mobile manager means a higher probability that the position of the superior will become vacant, or one might "ride on the coattails" of a competent mobile superior by following him or her through a series of promotions up the organizational hierarchy. At any rate, successful career planning requires a systematic scanning of the environment for opportunities and threats.

One has to be concerned not only about the present, but also about the future environment. This requires forecasting. Since there are a great many factors that need to be analyzed, planning one's career necessitates being selective and concentrating on those factors critical to personal success.

## 4. Analysis of Personal Strengths and Weaknesses[15]

For successful career planning, the environmental opportunities and threats must be matched with the strengths and weaknesses of individuals. Capabilities may be categorized as technical, human, conceptual, or design. As Figure 1.2 in Chapter 1 illustrates, the relative importance of these skills differs for the various positions in the organizational hierarchy, with technical skills being very important on the supervisory level, conceptual and design skills being crucial for top managers, and human skills being important at all levels.



**LEADERSHIP PERSPECTIVE**

### Career Path of Wal-Mart's Lee Scott—What is Yours?[16]

Effective human resource management should involve charting your career path. Your career strategy should be goal-oriented, but flexible enough to take advantage of opportunities. Probably many students can identity with the early career of Lee Scott, Wal-Mart's CEO. While studying at Pittsburg State University in Kansas, he worked at night making steel molds at a local factory. After earning his business degree, he worked for the trucking company Yellow Freight System as a dispatcher.

The first contact with Wal-Mart was in 1977 when he tried to collect a $7,000

bill. But Wal-Mart rejected the request. Nevertheless, during the dispute, Mr. Scott impressed Mr. Glass at Wal-Mart who offered him a job as assistant director of transportation, a job that involved setting up Wal-Mart's truck fleet. Fourteen years later, in 1993, Mr. Scott was promoted executive vice president of logistics, an area in which Wal-Mart later gained a competitive advantage. This was followed by the advancement to executive vice president for merchandising in 1995, executive vice president of Wal-Mart's stores division in 1998, vice chairman and chief operating officer in 1999, and CEO in 2000. In 2002, Wal-Mart under the leadership of Lee Scott, became the largest public corporation in the world, based in revenue.

Mr. Scott did not have an MBA from Harvard or Stanford or any other Ivy League school, but he offered Wal-Mart some special knowledge he gained while working for Yellow Freight. What are your strengths and what do you have to offer your potential employer that sets you on a path to success? ■■

## 5. Development of Strategic Career Alternatives

In developing a career strategy, one usually has several alternatives. The most successful strategy would be to build on one's strengths to take advantage of opportunities. For example, if a person has an excellent knowledge of computers and many companies are looking for computer programmers, he or she should find many opportunities for a satisfying career. On the other hand, if there is a demand for programmers and if an individual is interested in programming but lacks the necessary skills, the proper approach would be a development strategy to overcome the weakness and develop the skills in order to take advantage of the opportunities.

It may also be important to recognize the threats in the environment and develop a strategy to cope with them. If a person with excellent managerial and technical skills is working in a declining company or industry, the appropriate strategy might be to find employment in an expanding firm or in a growing industry.

## 6. Consistency Testing and Strategic Choices

In developing a personal strategy, one must realize that the rational choice based on strengths and opportunities is not always the most fulfilling alternative. Although one may have certain skills demanded in the job market, a career in that field may not be congruent with personal values or interests. For example, a person may prefer dealing with people to programming computers. Some may find great satisfaction in specialization, while others prefer to broaden their knowledge and skills.

Strategic choices require trade-offs. Some alternatives involve high risks while others involve low risks. Some choices demand action now; other choices can wait. Careers that were glamorous in the past may have an uncertain future. Rational and systematic analysis is just one step in the career-planning process, for a choice also involves personal preferences, personal ambitions, and personal values.

## 7. Development of Short-Range Career Objectives and Action Plans

So far, concern has centered on career direction. But the strategy has to be supported by short-term objectives and action plans, which can be a part of the performance appraisal process. Thus, if the aim is to reach a certain management position that requires a Master of Business degree, the short-term objective may be to complete a number of relevant courses. Here is an example of a short-term verifiable objective: to complete the course Fundamentals of Management by May 30 with a grade of A. This objective is measurable, as it states the task to be done, the deadline, and the quality of performance (the grade).

Objectives often must be supported by action plans. Continuing with the example, the completion of the management course may require preparing a schedule for attending classes, doing the homework, and obtaining the understanding and support of the spouse for sacrificing family time to attend the course. It is obvious that the long-term strategic career plan needs to be supported by short-term objectives and action plans.

## 8. Development of Contingency Plans

Career plans are developed in an environment of uncertainty and the future cannot be predicted with great accuracy. Therefore, contingency plans based on alternative assumptions should be prepared. While one may enjoy working for a small, fast-growing venture company, it may be wise to prepare an alternative career plan based on the assumption that the venture may not succeed.



## 9. Implementation of the Career Plan

Career planning may start during the performance appraisal. At that time, the person's growth and development should be discussed. Career goals and personal ambitions can be considered in selecting and promoting and in designing training and development programs.

## 10. Monitoring Progress

Monitoring is the process of evaluating progress toward career goals and making necessary corrections in the aims or plans. An opportune time for assessing career programs is during the performance appraisal. This is the time not only to review performance against objectives in the operating areas but also to review the achievement of milestones in the career plan. In addition, progress should be monitored at other times, such as at the completion of an important task or project.

LEADERSHIP PERSPECTIVE

## Career Planning in the New Economy

The traditional career model in which people prepared plans for working themselves up in a single organization needs to be modified. Today, people change jobs more frequently or even may work from their homes. There are more job opportunities. This is especially true for California's high-tech firms in the Silicon Valley with its rapidly changing business environment. While there are many opportunities in such an environment, job insecurity also increases. It is not unusual for a 32-year-old to have worked for nine different firms. California workers stay a medium of about three years with a company. Job seekers there are better informed as the Internet provides data on job openings as well as pay scales. It has been estimated that the turnover rate in the Silicon Valley is almost 20 percent a year.

But the Silicon Valley is not representative of America in general. Generally, Americans work longer hours than people in most European countries, such as France, Germany, and Sweden. On the other hand, Japanese workers put in similar hours as the Americans. The Japanese practice of lifelong employment is beginning to change, replaced by job insecurity. Furthermore, the use of temporary workers has also increased in Japan.

Perhaps more than ever before, developing a career strategy is important. Have a clear goal in mind, but be flexible and find alternative ways to reach it. Many people switch from big manufacturing firms to small service companies during the course of their career. In addition, it is essential to develop new skills needed for the new economy, join professional organizations, and invest in education and re-education because the rapid changes in the work environment demand new skills.

■■

## Strategy for Dual-Career Couples[17]

An effective career strategy requires that consideration be given to the career of the spouse. Dual-career couples, with both partners working, sometimes have to make very stressful choices. For example, if both partners have successful careers, the opportunity for a promotion that requires relocation poses a particularly painful situation. Some companies are accommodating the special needs of dual-career couples by having a flexible approach to transfers that involve relocation, considering the needs of both partners in career planning, helping to find employment for the spouse either within the company or outside, and providing maternity leave and day-care services for children. With the large number of married women in the workforce, an increasing number of companies have recognized the stressful situation of dual-career couples and incorporated more flexibility in their policies, in career planning, and in personnel selection, placement, and promotion.

## SUMMARY

Appraisal is essential for effective managing. It should measure performance in achieving goals and plans as well as performance as a manager. An effective method is to appraise managers against verifiable objectives. This approach is operational, related to the manager's job, and relatively objective. Still, a person may perform well (or badly) because of luck or factors beyond his or her control. Therefore, the management-by-objectives approach should be supplemented by appraisal of managers as managers, which assesses how well they perform their key managerial activities.

There are three kinds of reviews: (1) the formal comprehensive appraisal, (2) progress or periodic reviews, and (3) continuous monitoring. In a suggested appraisal program, key managerial activities are presented as checklist questions and grouped under the categories of planning, organizing, staffing, leading, and controlling.

Since managers differ greatly, they look for different rewards, such as opportunity and income. The job of a manager is also stressful, and this can affect the individual as well as the organization. Therefore, various ways of coping with stress have evolved.

Career planning can be effectively integrated with performance appraisal. Although the specific steps in developing a career strategy may vary, the process is similar to developing an organizational strategy. Since dual-career couples are quite common today, an effective career strategy must include consideration of the spouse's career.

## KEY IDEAS AND CONCEPTS FOR REVIEW



- ✔ Three kinds of reviews
- ✔ Appraisal against verifiable objectives
- ✔ Appraising managers as managers
- ✔ Team evaluation approach
- ✔ Rewards of managing
- ✔ Stress in managing
- ✔ Ten steps in formulating a career strategy
- ✔ Career strategy for dual-career couples

## FOR DISCUSSION

1. Do you think that managers should be appraised regularly? If so, how?
2. Many firms evaluate managers on such personality factors as aggressiveness, cooperation, leadership, and attitude. Do you think this kind of rating makes sense?
3. An argument has been made in this book for appraising managers on their ability to manage. Should anything more be expected of them?
4. How do you feel about an appraisal system based on results expected and realized? Would you prefer to be appraised on this basis? If not, why not?
5. On what basis should your performance in college be appraised?
6. What would you say to a student who tells you that he studied at least four hours every day in preparation for the mid-term examination and still got only a C?

7. Describe the most rewarding and most stressful aspects of your job or your college experience.
8. What is your career goal? Have you developed a plan to achieve your goal? If not, why?

## EXERCISES/ACTION STEPS

1. Interview two managers. Ask them what criteria are used for their performance appraisal. Are the criteria verifiable? Do these managers think that the performance evaluation measures their performance in a fair manner?
2. Develop a career plan for yourself. Identify a personal profile for yourself and state your long-range personal and professional goals. What are your strengths and weaknesses? Follow the steps explained in this chapter to develop a comprehensive strategic career plan for yourself.

## INTERNET RESEARCH

1. Access *Fortune* magazine's website and read on three topics in the "Careers" section. How can these sources help you in developing a career strategy?
2. Search the Internet for "performance appraisal." What criteria are used for evaluating performance? On what criteria would you like to be evaluated as a student, a subordinate, or a manager?

**Global Car Industry Case**

## Career Paths of CEOs at Toyota, Volkswagen (VW), Ford, and General Motors (GM)

Organizational strategies are to a great extent determined by CEOs. It is, therefore, important to learn about the career paths of the top executives. The focus is on the CEOs of the major car manufacturers of Toyota, Volkswagen, Ford, and General Motors.

**Akio Toyoda, President and CEO of Toyota[18]**

Mr. Toyoda, the grandson of the founder of Toyota, was born in 1956. He earned a law degree from Keio University in Japan and a Master of Business Administration from Babson College in the United States. He joined Toyota in 1984, became Executive Vice President in 2005, and President in 2009 at the time the company had an extensive car recall campaign for quality defects. Shortly after assuming the position, he apologized to the United States Congress for the vehicle recalls. At the age of 53, he is a young president by Japanese standards. He took office when Toyota reported the biggest annual loss.

He spent seven years in the United States and speaks fluent English. When asked about comparing life in America and Japan, he liked the feeling of freedom in the U.S. In contrast, life is more restricted in Japan because it is a small country and people live close together; this requires more consideration for others.

He enjoyed working on the factory floor more than sitting in the office which is necessary for his job as CEO. He is interested in racing cars and views the challenge for the car industry as using the available energy resources effectively and efficiently. This is one of the reasons Toyota focuses on the development of the fuel-efficient hybrid cars, illustrated by the best-selling Prius model.

In his early tenure as president, Akio Toyoda had to face many challenges such as the financial condition of the company, the car recall, and the damage caused by the 2011 earthquake disaster.

**Martin Winterkorn, CEO and Chairman of the Board of Volkswagen (VW)[19]**

Mr. Winterkorn was born in 1947 and became Chairman of the Volkswagen Board in 2007. He studied metallurgy and metal physics from 1966 to 1973 at the University of Stuttgart. In 1977 he earned his doctorate from the prestigious Max-Planck Institute for metal research and metal physics. He then joined Robert Bosch GmbH working in the refrigerant compressor group. In 1993 he became the director of the Group Quality Assurance at Volkswagen and worked in various technical fields. In 2002, he became head of the Audi group which includes brands such as SEAT and Lamborghini.

The Volkswagen Group includes passenger cars and large vehicles. The International Group consists of Volkswagen of America, Brasil, China, India, and Ireland. The company also has major interests in Porsche AG, MAN SE., Suzuki Motor Corporation, and Italdesign Giugiaro among others.

The goal of Martin Winterkorn is to make Volkswagen the largest car company by 2018. Winterkorn's strategy is to overtake, by sales volume, the current leader Toyota. Some of the first moves are the expansion of the operations in China and in Chattanooga, Tennessee, U.S.A. where the mid-size Passat will be built. Some specific goals are to be an attractive employer, achieve the greatest customer satisfaction, and have a pre-tax return on sales of over 8 percent. Winterkorn also plans to improve the brands like Audi, SEAT, and Skoda.



**Alan Mulally, President and CEO of Ford Motor Company[20]**

Mr. Mulally, who considers himself as being an engineer and businessman, was born in 1945. He graduated with a Bachelor of Science degree and a Master of Science degree in astronautical engineering from the University of Kansas. He also earned a master's degree in management as a Sloan Fellow at MIT. Before joining Ford, he served as Executive-Vice President of Boeing Company and CEO of Boeing's commercial airplanes group. Mulally started at Boeing as an engineer in 1969 and has been credited with making Boeing competitive with Airbus, the European consortium.

In 2006, Mulally became CEO and President of Ford. He was named one of "The Best Leaders of 2005" by *Business Week* magazine and *AUTOWEEK* called him Top CEO. During the financial crisis in the late 2000s, Ford was the only American automobile manufacturer that avoided government-sponsored bankruptcy.

**Daniel F. Akerson, Chairman and Executive Officer of General Motors (GM)[21]**

Mr. Akerson was born in 1948. He earned his Bachelor of Science degree from the U.S. Naval Academy in 1970 and his Master of Science degree from the London School of Economics. Since 2010, he is the CEO of GM and became Chairman in 2011. He joined the GM board as a representative of the government.

Before joining GM, he was the managing director of the Carlyle Group, a private equity company (2003 to 2010). In addition, he also had extensive experience with several other

companies, including XO Communication (1999 to 2003), Nextel Communication (1996-1999),General Instrument (1993-1995), and MCI Communication (1983-1993).

While with the Carlyle Group, he gained experience in company buyouts in Asia and Europe as well as providing other services in Japan and America. For example, he formulated and implemented MCI's global strategy. At Nextel, he helped the company to become a national digital wireless provider. Clearly, he has a strong background in telecommunication.

Before becoming GM's CEO, he served on GM's Board as well as on the Board of the American Express firm. With his background in the financial industry, he is attractive to GM investors, but is not a person with hands-on car experience. Akerson is a relatively unknown in the car industry. However, his goal is to make GM cars better than those from competitors such as BMW.

**Questions**

1. Which CEO do you think has the best experience for succeeding in the automobile industry and why?
2. Do you think that management skills are transferable between industries? If you say "no," how successful do you think Daniel Akerson will be at General Motors?
3. What is your career path? Is it in a technical field like finance, marketing, or operations, or is it yet another path?
4. Do you want to work in a line or staff position? Why? What makes a line or staff position attractive to you?

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# MAJOR PRINCIPLES OR GUIDES FOR THE MANAGERIAL FUNCTION OF STAFFING

As mentioned in the Part Closings for planning and organizing, a complete set of empirically proven, interrelated principles have not been discovered and codified, experience and observation of managing indicate certain fundamental managerial principles or guides. Each principle is given a number with a letter that represents that type of managerial function. The letter "S" means that the principle pertains to staffing.

## Major Principles or Guides for Staffing

There are no universally accepted staffing principles. Nevertheless, those listed ahead are useful as guidelines for understanding the staffing function:

## The Purpose of Staffing

The purpose of staffing is summarized by the following principles.

S1. *Principle of the objective of staffing.* The objective of managerial staffing is to ensure that organizational roles are filled by qualified personnel who are able and willing to occupy them.

S2. *Principle of staffing.* The clearer the definition of organizational roles and their human resource requirements, and better the techniques of manager appraisal and training employed, the higher the managerial quality.

The first principle stresses the importance of the desire and ability to undertake the responsibilities of management. There is considerable evidence of failure to achieve results when these qualities are lacking. The second principle rests on an important body of knowledge concerning management practices. Organizations that have no established job definitions, no effective appraisals, and no system for training and development will have to rely on coincidence or outside sources to fill positions with able managers. On the other hand, enterprises applying the systems approach to staffing and human resource management will utilize the potentials of people in the enterprise more effectively and efficiently.

## The Process of Staffing

The following principles indicate the means for effective staffing:

S3. *Principle of job definition.* The more precisely the results expected of managers are identified, the more the dimensions of their positions can be defined.

| | | |
|---|---|---|
| S4. | *Principle of managerial appraisal.* | The more clearly verifiable objectives and required managerial activities are identified, the more precise can be the appraisal of managers against these criteria. |
| S5. | *Principle of open competition.* | The more an enterprise is committed to the assurance of quality management, the more it will encourage open competition among all candidates for management positions. |

The first principle is similar to the principle of functional definition in organizing. Since organizational roles are occupied by people with different needs, these roles must have many dimensions such as pay, status, power, discretion, and job satisfaction that induce managers to perform.

The second principle suggests that performance should be measured both against verifiable objectives—as in an appraisal approach based on management by objectives–and against standards of performance as managers. The appraisal of managers as managers considers how well the key managerial activities within the functions of planning, organizing, staffing, leading, and controlling are carried out.

Violation of the open competition principle has led many firms to appoint managers with inadequate abilities. Although social pressures strongly favor promotion from within the enterprise, these forces should be resisted whenever better candidates can be brought in from the outside. At the same time, the application of this principle obligates an organization to appraise its people accurately and to provide them with opportunities for development.

| | | |
|---|---|---|
| S6. | *Principle of management training and development.* | The more management training and development is integrated with the management process and enterprise objectives, the more effective the development programs and activities will be. |
| S7. | *Principle of training objectives.* | The more precisely the training objectives are stated, the more likely are the chances of achieving them. |
| S8. | *Principle of continuous development.* | The more an enterprise is committed to managerial excellence, the more it requires that managers practice continuous self-development. |

The first of these three principles suggests that, in the systems approach, training and development efforts are related to the managerial functions, the aims of the enterprise, and the professional needs of managers.

The analysis of training needs is the basis for determining training objectives that give direction to development and facilitate the measurement of the effectiveness of training efforts. The second principle brings into focus the contribution that training makes to the purpose of the enterprise and the development of individuals.

The third principle reminds us that in a fast-changing and competitive environment, managers cannot stop learning. Instead, they have to update their managerial knowledge continually, reevaluate their approaches to managing, and improve their managerial skills and performance to achieve results.

# 13 Managing Change through Manager and Organization Development

## CHAPTER OBJECTIVES

After studying this chapter, you should be able to:

- Distinguish between manager development, managerial training, and organization development
- Discuss the manager development process and training
- Describe the various approaches to manager development
- Identify changes and sources of conflict and show how to manage them
- Describe the characteristics and process of organization development
- Understand the learning organization



This chapter deals with change. First, the focus is on the change of individuals, specifically manager development and training. However, people do not operate in isolation. Consequently, in the second part of this chapter, the emphasis shifts to groups of individuals and organizations.

Excellent executives look to the future and prepare for it. One important way to do this is to develop and train managers so that they are able to cope with new demands, new problems, and new challenges. Indeed, executives have a responsibility to provide training and development opportunities for their employees so that they can reach their full potential.

**Manager development** The use of long-term, future-oriented programs to develop a person's ability in managing.

**Managerial training** The use of programs (mostly short-term) that facilitate the learning process to help managers do their jobs better.

The term **manager development** refers to long-term future-oriented programs and the progress a person makes in learning how to manage. **Managerial training**, on the other hand, pertains to the programs that facilitate the learning process and is mostly a short-term activity to help managers do their jobs better. In this book, **organization development** is a systematic, integrated, and planned approach to improving the effectiveness of groups of people and of the whole organization or a major organizational unit. Organization development uses various techniques for identifying and solving problems.

**Organization development** A systematic, integrated, and planned approach to improving the effectiveness of groups of people and of the whole organization or a major organizational unit.

Essentially, organization development focuses on the total organization (or a major segment of it), while manager development concentrates on individuals. These approaches support each other

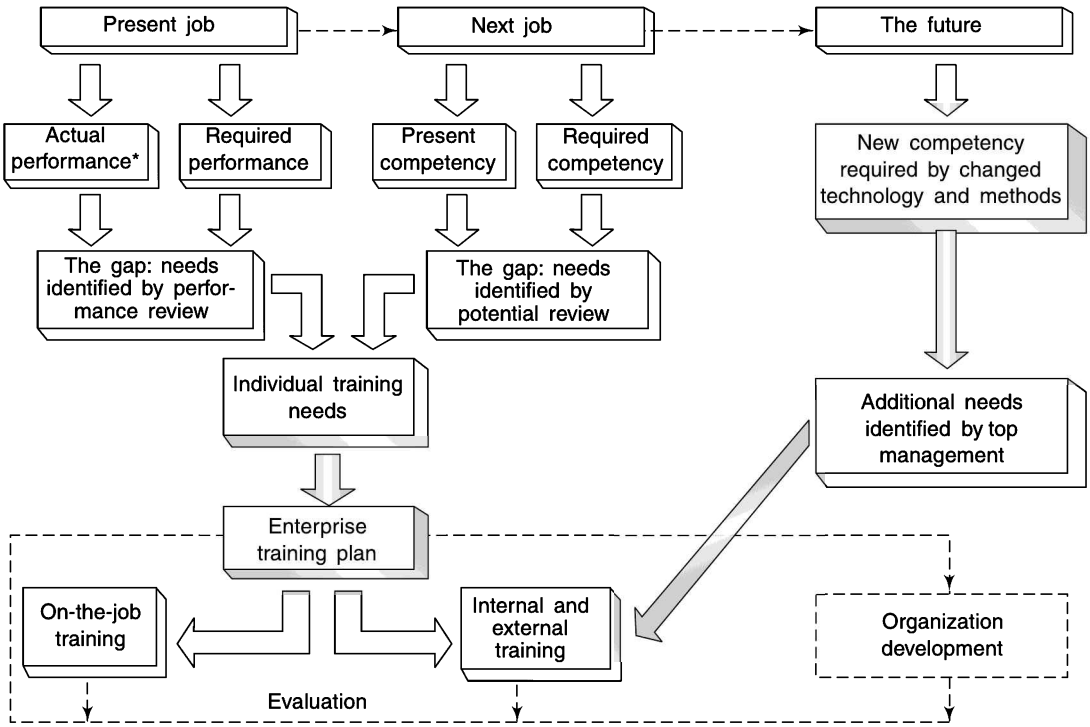
and should be integrated to improve the effectiveness of both the managers and the enterprise.

## MANAGER DEVELOPMENT PROCESS AND TRAINING

Before specific training and development programs are chosen, three kinds of needs must be considered. First, the needs of the organization include such items as the objectives of the enterprise, the availability of managers, and turnover rates. Second, needs related to operations and the job itself can be determined from job descriptions and performance standards. Third, data about individual training needs can be gathered from performance appraisals, interviews with the jobholder, tests, surveys, and career plans for individuals. Let us look more closely at the steps in the manager development process, focusing first on the present job, then on the next job in the career ladder, and finally on the long-term future needs of the organization. The steps in manager development are depicted in Figure 13.1.

**Figure 13.1**

**Manager Development Process and Training.**
**Adapted from John W. Humble, *Improving Business Results* [Maidenhead, England: McGraw-Hill Book Company (UK) Ltd., 1968]**




*This includes performance measured against verifiable objectives and performance in carrying out key managerial activities.

LEADERSHIP PERSPECTIVE

## India's Leadership Needs[1]

With India's growth, companies need leadership. Salaries of expatriate managers are increasing the costs of goods and services. Moreover, they often do not have the experience in dealing with the diverse labor force which is shaped by many cultures. On the other hand, there is a lack of local people with managerial and leadership skills. Indian companies, in order to sustain their success, need to pay more attention to develop managerial talent. Since people are the most important assets, the focus should be on the critical variables in the systems approach to staffing as previously shown in Figure 11.1. Moreover, the manager development process and training model shown in Figure 13.1 indicates the need to not only focus on the present job but also on the next job and on the future. The systematic analysis of the individual and organizational training needs become the basis for the enterprise training plan which may be the key factor for success. ■■

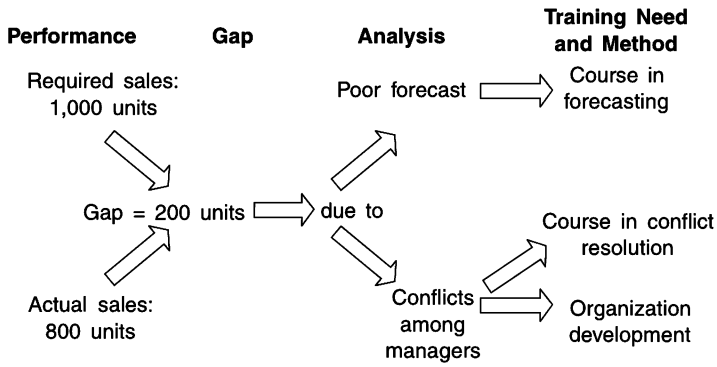
## Present Job

Manager development and training must be based on needs analysis derived from a comparison of actual performance and behavior with required performance and behavior. Such an analysis is shown in Figure 13.2. A district sales manager has decided that 1,000 units is a reasonable sales expectation, but the actual sales are only 800, which is 200 units short of the target. Analysis of the deviation from the target might indicate that the manager lacks the knowledge and skills for making a forecast and that conflict between subordinate managers hinders effective teamwork. On the basis of this analysis, training needs and methods for overcoming the deficiencies are identified. Consequently, the district sales manager enrolls in courses



**Figure 13.1**

**Analysis of Training Needs.**



in forecasting and conflict resolution. Furthermore, organization development efforts are undertaken to facilitate cooperation among organizational units.

## Next Job

As shown in Figure 13.1, a similar process is applied in the identification of the training needs for the next job. Specifically, present competency is compared with the competency demanded by the next job. A person who has worked mainly in production may be under consideration for a job as a project manager. This position requires training in functional areas such as engineering, marketing, and even finance. This systematic preparation for a new assignment certainly is a more professional approach than simply thrusting a person into a new work situation without training.

## Future Needs

Progressive organizations go one step further in their training and development approach—they prepare for the more distant future. This requires that they forecast what new competencies will be demanded by changing technology and methods. For example, energy shortages may again occur, and this requires that managers be trained not only in the technical aspects of energy conservation but also in energy-related long-range planning and creative problem solving. In the new millennium, training in e-business is essential. In Europe especially, the impact of m-business (mobile and wireless business) has been taught in training programs. These changes, created by the external environment, have to be integrated into enterprise training plans, with a focus on the present as well as the future. These plans are contingent not only on the training needs but also on the various approaches to manager development that are available.

**LEADERSHIP PERSPECTIVE**

### Managing Human Resources at PriceWaterhouseCoopers in China[2]

www.pwcglobal.com

PriceWaterhouseCoopers (PWC) is the largest company in China that provides assurance and business advisory services, management consulting services, and tax and legal services. Its more than 3,000 employees, with a wealth of local experience, help international as well as local clients with business solutions.

The management of human resources is of critical importance for the success of the company. Great emphasis is placed on recruiting in schools. Selecting from among the many candidates is a thorough process that includes close contacts with university personnel who can identify potential candidates. Moreover, résumés posted on websites are also scanned for qualified candidates, who have to show proficiency in the English language.

The selection process includes initial interviews, workshop exercises, additional interviews, and the hiring decision. After being hired, the recruits have to undergo extensive training that includes lectures, audiovisual material, simulations, and self-study programs. Performance and progress are assessed through the appraisal process. The company employs behaviorally anchored rating scales as well as other instruments which focus on specific, measurable objectives that are agreed upon by the superior and the subordinate.

The PWC approach to the management of human resources illustrates how managerial practices can be transferred through global companies by the use of modern management tools. ■■

## APPROACHES TO MANAGER DEVELOPMENT: ON-THE-JOB TRAINING

Many opportunities for development can be found on the job. Trainees can learn as they contribute to the aims of the enterprise. However, because this approach requires competent higher-level managers who can teach and coach trainees, there are limitations to on-the-job training.

### Planned Progression

**Planned progression** gives managers a clear idea of their path of development.

Planned progression is a technique that gives managers a clear idea of their path of development. Managers know where they stand and where they are going. For example, a lower-level manager may have available an outline of the path from superintendent to works manager and eventually to production manager. The manager then knows the requirements for advancement and the means of achieving it. Unfortunately, there may be an overemphasis on the next job instead of on good performance of present tasks. Planned progression may be perceived by trainees as a smooth path to the top, but it really is a step-by-step approach which requires that tasks be done well at each level.



### Job Rotation

**Job rotation** is intended to broaden the knowledge of managers or potential managers in different enterprise functions.

The purpose of job rotation is to broaden the knowledge of managers or potential managers. Trainees learn about the different enterprise functions by rotating into different positions. They may rotate through (1) nonsupervisory work, (2) observation assignments (observing what managers do, rather than actually managing), (3) various managerial training positions, (4) middle-level "assistant" positions, and even (5) various managerial positions in different departments such as production, sales, and finance.

The idea of job rotation is good, but there are difficulties. In some job rotation programs, participants do not actually have managerial authority. Instead, they observe or assist line managers, and they do not have the responsibility they would have if they were actually managing. Even in rotations to managerial positions, the participants in the training program may not remain long enough in each position to prove their future effectiveness as managers. Furthermore, when the rotation pro-

gram is completed, there may be no suitable positions available for the newly trained managers. Despite these drawbacks, if both managers and trainees understand the inherent difficulties, job rotation has positive aspects and should benefit trainees.

## Creation of "Assistant-to" Positions

**"Assistant-to" positions** are often created to broaden the viewpoints of trainees through working closely with experienced managers.

"Assistant-to" positions are frequently created to broaden the viewpoints of trainees by allowing them to work closely with experienced managers who can give special attention to the development needs of trainees. Managers can, among other things, give selected assignments to test the judgment of trainees. As in job rotation, this approach can be very effective when superiors are also qualified teachers who can guide and develop trainees until they are ready to assume full responsibilities as managers.

## Temporary Promotions

**Temporary appointment** to acting manager is used to cover the responsibilities of the absent manager.

Individuals are frequently appointed as "acting" managers when, for example, the permanent manager is on vacation, is ill, or is making an extended business trip, or even when a position is vacant. Thus, temporary promotions are a developmental device as well as a convenience to the enterprise.

When the acting manager is given the authority to make decisions and to assume full responsibility, the experience can be valuable. On the other hand, if such a manager is merely a figurehead, makes no decisions, and really does not manage, the developmental benefit may be minimal.

## Committees and Junior Boards

**Committees and junior boards**, also known as multiple management, give trainees the opportunity to interact with experienced managers.

Committees and junior boards, also known as multiple management, are sometimes used as developmental techniques. These give trainees the opportunity to interact with experienced managers. Furthermore, trainees, usually from the middle but sometimes from the lower level, become acquainted with a variety of issues that concern the whole organization. They learn about the relationships between different departments and the problems created by the interaction of these organizational units. Trainees may be given the opportunity to submit reports and proposals to the committee or the board and to demonstrate their analytical and conceptual abilities. On the other hand, trainees may be treated in a paternalistic way by senior executives and may not be given opportunities to participate, an omission that might frustrate and discourage them. The program would then be detrimental to their development.

## Coaching

**Coaching** must be done in a climate of confidence and trust, with the aim of developing subordinates' strengths and overcoming their weaknesses.

On-the-job training is a never-ending process. A good example of on-the-job training is athletic coaching. To be effective, coaching, which is the responsibility of every line manager, must be done in a climate of confidence and trust between the superior and the trainees. Patience and wisdom are required of superiors, who must be able

to delegate authority and give recognition and praise for jobs well done. Effective coaches will develop the strengths and potentials of subordinates and help them overcome their weaknesses. Coaching requires time; but if done well, it will save time and money and will prevent costly mistakes by subordinates. Thus, in the long run, it will benefit all—the superior, the subordinates, and the enterprise.

## APPROACHES TO MANAGER DEVELOPMENT: INTERNAL AND EXTERNAL TRAINING[3]

As indicated in Figure 13.1, besides on-the-job training, there are many other approaches to manager development. These programs may be conducted within the company, or they may be offered externally by educational institutions and management associations.

### Conference Programs

**Conference programs** expose managers or potential managers to the ideas of speakers who are experts in their field.

Conference programs may be used in internal or external training. They expose managers or potential managers to the ideas of speakers who are experts in their field. Within the company, employees may be instructed in the history of the firm and its purposes, policies, and relationships with customers, consumers, and other groups. External conferences may vary greatly, ranging from programs on specific managerial techniques to programs on broad topics, such as the relationship between business and society.

These programs can be valuable if they satisfy a training need and are thoughtfully planned. A careful selection of topics and speakers will increase the effectiveness of this training device. Furthermore, conferences can be made more useful by including discussions, as two-way communication allows participants to ask for clarification of topics that are particularly relevant to them.



### University Management Programs

University management programs expose managers to theories, principles, and new developments in management.

Besides offering undergraduate and graduate degrees in business administration, many universities now conduct courses, workshops, conferences, and formal programs for training managers. These offerings may include evening courses, short seminars, live-in programs, a full graduate curriculum, or even programs tailored to the needs of individual companies. Some executive development centers even provide career development assistance with programs designed to fit typical training and development needs of first-line supervisors, middle managers, and top executives.

These university programs expose managers to theories, principles, and new developments in management. In addition, there is usually a valuable interchange of experience among managers who, in similar positions, face similar challenges.

INTERNATIONAL PERSPECTIVE

### How to Get into the Business School of Your Choice[4]

Even experienced managers may decide to go back to school. Disappointment may occur when applicants are told that they are denied admission or that they are "wait-listed." However, such a notice should not discourage but stimulate the search for the reason for their unsuccessful application. Here are some ideas about what admissions officers may look for: Is there a gap in the employment record? What does a candidate offer in special skills or knowledge? Are the strengths of the candidate effectively articulated? What does the person want to do with the degree? Does the candidate show that he or she is different (e.g., speaking different languages, having had international experience)? Does the career path show a rapid promotion?

A generic application letter is usually not sufficient. The applicant should learn about the school and, if possible, visit the university and meet faculty members and students. An advanced degree or special courses may be the pathway to a successful career. ■■

## In-House "Universities"

One of the earliest in-house educational facilities was established by General Electric's CEO Ralph Cordiner in the mid- to late 1950s in Crotonville, New York. Jack Welch the recently retired GE CEO, liked to teach at Crotonville on his favorite strategy theme of making GE's units No. 1 and No. 2 in the market.[5] Crotonville became GE's center for learning.

Another well-known center for in-company learning is McDonald's University near Chicago. It has its own library and modern electronic classrooms, in which managers study how to operate McDonald's restaurants. Similar universities are located strategically in several parts of the world. Many companies have established their own universities.

Other companies engaged in their own training and development of managers are Intel, FedEx, Capital One, and many others. German companies known for their comprehensive apprenticeship training have expanded their programs to include managerial education. For example, SAP (known for its software offerings) and BASF (a multinational chemical firm) have supplemented their programs with a program at the University of Applied Sciences in Ludwigshafen, Germany.

Still another example of in-house development is the IBM's Peace Corps-Type Training.[6] IBM is well known for its classroom training of its personnel. The real world, however, is different from the classroom and therefore, the HR department initiated a program that is modeled after the US Peace Corps program. The objective of the program is to teach managers how the real world works. In this innovative program, IBMers spend a month in countries such as India, Brazil, Malaysia, South Africa, and

others to learn about the culture and to become a kind of global citizen. This means living in circumstances different from their home country—not luxury hotels with CNN connections, but guest houses eating local food. Program participants work in teams with local governments, universities, and businesses to help them upgrade their technologies and improving water quality. This one-month program will not make the participants instant global experts, but they learn that the earth is "flatter" in which people from different cultures work together to achieve common goals.

**LEADERSHIP PERSPECTIVE**

### Preparing Leaders to Think about the Future at Singularity University[7]

Located at the NASA Ames Research Center in California, Singularity University is not a traditional university. Instead, the aim is to attract executives who deal with disruptive technologies in a rapidly-changing environment dealing with such topics as robotics. The participants work in small groups to explore new ideas. Applicants from some 60 countries explore, for example, the future of the application of artificial intelligence to assume certain functions of the brain. ■■

## Readings, Television, Video Instruction, and Online Education[8]



Another approach to development is planned reading of relevant and current management literature. This is essentially self-development. A manager may be aided by the training department, which often develops a reading list of valuable literature. This learning experience can be enhanced through discussion of articles and books with other managers and the superior.

www.education.com
www.ucla.edu
www.phoenix.edu
www.uchicago.edu
www.columbia.edu
www.stanford.edu
www.lse.ac.uk
www.cmu.edu
www.cardean.edu
www.blackboard.com
www.webct.com

Increasingly, management and other topics are featured in television instruction programs. For certain programs, college credits can be obtained. Moreover, videotapes on a variety of subjects are available for instruction and learning in the university or company classroom.

Investment in online education is growing. The providers of online education can be categorized into three groups: (1) schools, (2) universities, and (3) business and commercial training organizations.[9] Universities use the new technologies for graduate programs and extension courses. At the University of California, Los Angeles, most of the 3,000 undergraduate courses are accompanied by websites containing lecture notes and supplementary material; even tests can be taken online. The University of Phoenix mixes distance learning with evening classes. Business schools such as the University of Chicago, Columbia University, Stanford University, the London School of Economics, and Carnegie Mellon University work with Cardean University to offer complete online courses. Firms such as Blackboard and WebCT have developed platforms for placing course material on the Web. Although online education can be helpful, skeptics question the profitability and effectiveness of the application of the new technologies.

## Business Simulation and Experiential Exercises

Business games and experiential exercises have been used for some time, but the introduction of computers has made these approaches to training and development even more popular. The computer, however, is only one of several tools; many of the exercises do not require any hardware at all.

www.towson.edu/~absel

The great variety of business simulations is best illustrated by the topics discussed at meetings of the Association for Business Simulation and Experiential Learning (ABSEL). The approaches range from behavioral exercises dealing, for example, with attitudes and values to simulations in courses such as marketing, accounting, decision support systems, and business policy and strategic management.

## E-Training[10]

www.mcdonalds.com
www.thrifty.com
www.circuitcity.com

With operations in many places, companies such as McDonald's, Thrifty Car Rental, and Circuit City offer Web-based training classes, which may be more cost-effective than traditional classroom training. McDonald's, for example, started its pilot Web training in 2001 with 3,000 employees in four languages in six countries. Various approaches are possible. One is the off-the-shelf content. Another approach is to create a virtual classroom with the teacher interacting with students. Synchronous e-learning with live instructions appears to be more effective than self-paced learning that requires self-discipline. Live instructions can be adapted to the needs of students at the particular time by integrating overhead transparencies, slides, and lecture notes. One approach is to blend off-the-shelf programs with live e-training.

www.ibm.com
www.irs.gov
www.nol.com.sg

E-learning has been successfully used in knowledge-intensive companies, such as IBM's Basic Blue e-learning approach. More recently, e-training is employed for teaching skills. The U.S. Internal Revenue Service uses Web-based training, and so does Neptune Orient Lines, the large transporter of containers. The container company has to train its global workforce in various countries in Europe, Asia, South America, and other regions. Instead of sending trainers around the world, it uses live e-learning as a cost-effective alternative.

The trend of e-learning is just in its early stages. More research will have to be done to make it more effective and to find the proper balance between self-paced learning and instructor-led training.

## Special Training Programs

Management development must take an open-system approach that responds to the needs and demands of the external environment. There is an increasing awareness of the need for training programs specifically designed for members of minority groups and for the physically handicapped. Many firms have made special efforts to train these people so that they may utilize their full potential while contributing to the aims of the enterprise.

Companies may also offer special programs on selected subjects. The topic of ethics may be discussed to give the workforce guidelines on ethical behavior. The subject of corporate culture may be addressed in a formal or informal manner. Japanese

companies in particular are known for making special efforts to instill the company philosophy in employees to promote a desirable corporate culture.

LEADERSHIP PERSPECTIVE

### Cisco's Leadership Talent Development in India and Elsewhere[11]

For several years, Cisco has focused on emerging markets. For example, the company used a hyperactive approach for recruiting and developing people in India. The second headquarters in Bangalore allows Cisco to recruit the local talent. In addition, Cisco started the Global Talent Acceleration Program operating in Saudi Arabia, Jordan, and South Africa looking for people who worked in two continents and speak two languages. The recruits get six months of training in selling and finance. Mentoring is done by assigning those recruits to experienced managers. This program encourages employees to contribute $100 to help micro-startups in the rural areas in India. The idea is that another "Bill Gates" may be discovered. ■■

## EVALUATION AND RELEVANCE OF TRAINING PROGRAMS

Determining the effectiveness of training programs requires measurements against standards and a systematic identification of training needs and objectives.

Determining the effectiveness of training programs is difficult. It requires measurements against standards and a systematic identification of training needs and objectives.

In general, development objectives include (1) an increase in knowledge, (2) development of attitudes conducive to good managing, (3) acquisition of skills, (4) improvement of management performance, and (5) achievement of enterprise objectives.

If training is to be effective, it is extremely important that the criteria used in the classroom situation resemble as closely as possible to the criteria relevant to the working environment. Manager development requires a situational approach in which training objectives, techniques, and methods are sufficiently congruent with the values, norms, and characteristics of the environment.



LEADERSHIP PERSPECTIVE

### Making Management Education Relevant

In order to make business courses more meaningful, many schools invite guest speakers from industry to share their experiences. This creates close ties between business schools and enterprises. Executives become aware of the quality of each school's curriculum, and students may find it advantageous to know about the companies when they are looking for a job. Moreover, executives often serve on school

advisory boards, and this makes the schools aware of the needs of the business community. This does not mean, however, that market-driven schools should adopt any management fad. Instead, management education must be broad enough to encompass the teaching of all key managerial activities in planning, organizing, staffing, leading, and controlling. ■■

## MANAGING CHANGE[12]

The forces for change may come from the external environment, from within the organization, or from the individuals themselves.

The forces for change may come from the environment external to the firm, from within the organization, or from the individuals themselves.

### Changes that Affect Manager and Organization Development

Several trends, some of them already occurring, will have implications for developing human resources. Here are illustrations:

- The increasing use of computers, especially microcomputers, requires that teachers as well as students become computer-literate.
- Education extends into the adult life. Lifelong learning becomes a necessity, and educational institutions and enterprises must recognize the special educational needs of adults.
- The proportion of knowledge workers will increase and the need for skill workers will decrease, which may require more training in knowledge, conceptual, and design skills.
- The shift from manufacturing to service industries requires retraining in preparation for new positions.
- The choice of educational opportunities will expand. For example, many companies already are conducting their own training programs.
- There may be greater cooperation and interdependence between the private and the public sector, at least in some countries, such as Canada.
- Internationalization will continue, so managers must learn to communicate with and to adapt to managers in other countries. Companies need to train with a global perspective.

There are various ways to respond to these forces. One approach is simply to react to a crisis. Unfortunately, this is usually not the most effective response. Another approach is to deliberately plan the change. This may require new objectives or policies, organizational rearrangements, or a change in leadership style and organization culture.

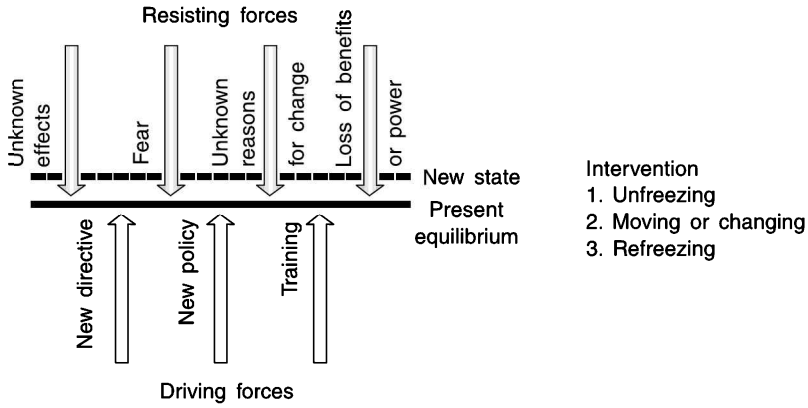
### Techniques for Initiating Change

**Field force theory** An equilibrium is maintained by driving forces and restraining forces.

Organizations may be in a state of equilibrium, with forces pushing for change on the one hand and forces resisting change by attempting to maintain the status quo on the other. Kurt Lewin expressed this phenomenon in his **field force theory**, which suggests that an equilibrium is maintained by *driving* forces and *restraining* forces, as shown in Figure 13.3.[13] In initiating change, the tendency is to increase the driving

**Figure 13.3**

**Moving an Organizational Equilibrium.**




forces. This may indeed produce some movement, but it usually also increases resistance by strengthening the restraining forces. Another approach, one that is usually more effective, is to reduce or eliminate the restraining forces and then move to a new level of equilibrium. In organizations, a change in policy is less resisted when those affected by it participate in the change.

The change process involves three steps: (1) unfreezing, (2) moving or changing, and (3) refreezing.[14] The first stage, unfreezing, creates the motivation for change. If people feel uncomfortable with the present situation, they may see the need for change. However, in some cases, an ethical question may arise regarding the legitimacy of deliberately creating discomfort that may initiate change.

The second stage is the change itself. This change may occur through assimilation of new information, exposure to new concepts, or development of a different perspective. The third stage, refreezing, stabilizes the change. Change, to be effective, has to be congruent with a person's self-concept and values. If the change is incongruent with the attitudes and behaviors of others in the organization, chances are that the person will revert to the old behavior. Thus, reinforcement of the new behavior is essential.



## Resistance to Change

There are many reasons why people resist change. Here are a few examples:

- What is not known causes fear and induces resistance. An organizational restructuring can leave a person uncertain about its effect on his or her job. People want to feel secure and have some control over the change.
- Not knowing the reason for the change also causes resistance. In fact, it is often unclear to those affected why the change is necessary at all.
- Change may also result in a reduction of benefits or a loss of power.

Reduction of resistance can be achieved in many different ways. The involvement of organization members in planning the change can reduce uncertainty.

Communication about proposed changes also helps clarify the reasons or effects of the changes. Some approaches focus on the people involved in the change; others involve changes in organization structure or technology. The sociotechnical systems approach shown in Figure 1.3 in Chapter 1 suggests that effective organization requires consideration of both the social and the technical dimensions in an enterprise.

## ORGANIZATIONAL CONFLICT

Conflict is a part of organizational life and may occur within the individual, between individuals, between the individual and the group, and between groups.

Conflict is a part of organizational life and may occur within the individual, between individuals, between the individual and the group, and between groups. While conflict is generally perceived as dysfunctional, it can also be beneficial because it may cause an issue to be presented in different perspectives. As one top executive of a major company maintained, if there was no conflict on an issue, it could not have been sufficiently analyzed, and the final decision on the issue was usually postponed until all aspects were critically evaluated.

### Sources of Conflict

There are many potential sources of conflict. Today's organizations are characterized by complex relationships and a high degree of task interdependence, so friction can easily occur. Moreover, the goals of the parties are often incompatible, especially when the parties compete for limited resources. People also have different values and different perceptions of issues. A production manager may take the position that streamlining the product line and concentrating on a few products can make the organization more productive, while a sales manager may desire a broad product line that will satisfy diverse customer demands. An engineer may want to design the best product regardless of cost or market demand considerations.

Conflict can arise from other sources as well. There may be conflict between people in line and staff positions. A superior's autocratic leadership style may cause conflict. Differing educational backgrounds are potential sources of conflict. Perhaps most often mentioned is lack of communication. Many of these topics are discussed in various chapters of this book.

### Managing Conflict

Conflict can be managed in different ways, some focusing on interpersonal relationships and others on structural changes.

Conflict can be managed in different ways, some focusing on interpersonal relationships and others on structural changes. Avoidance of the situation that causes the conflict is an example of an interpersonal approach. Another way of coping with conflict is through smoothing, emphasizing the areas of agreement and common goals, and de-emphasizing disagreements. A third way is forcing, pushing one's own view on others; this will of course cause overt or covert resistance. A traditional way of coping with conflict is to compromise, agreeing in part with the other person's view or demand.

Attempts can also be made to change the behavior of individuals, a very difficult task indeed. At times, it may also be possible to reassign an individual to another organizational unit. In many situations, conflict is resolved by a person higher up in

the organization who has sufficient authority to decide an issue. However, if the solution is perceived as being unfair, the loser may attempt to get even with the winner at a later time, thus perpetuating the conflict. In the problem-solving approach to organizational conflict, differences are openly confronted and the issues are analyzed as objectively as possible.

Another way of coping with conflict is to make structural changes. This means modifying and integrating the objectives of groups with different viewpoints. Moreover, the organization structure may have to be changed and authority–responsibility relationships clarified. New ways of coordinating activities may have to be found. Tasks and work locations can also be rearranged. In one workroom in a firm, for example, machines were placed in a way that prevented conflicting parties from interacting with one another. Often one must not only decide on the necessary changes but also select the appropriate process. For this reason, the next section focuses on organization development.

## ORGANIZATION DEVELOPMENT

As explained earlier, **organization development**, typically shortened to OD, is a systematic, integrated, and planned approach to improving enterprise effectiveness. It is designed to solve problems that decrease operating efficiency at all levels. Such problems may include lack of cooperation, excessive decentralization, and poor communication.

The techniques of OD may involve laboratory training (e.g., people communicating in a group situation), managerial-grid training, and survey feedback. Some OD practitioners also use team building, process consultation, job enrichment, organizational behavior modification, job design, stress management, career and life planning, and management by objectives as part of their approach.



### The Organization Development Process

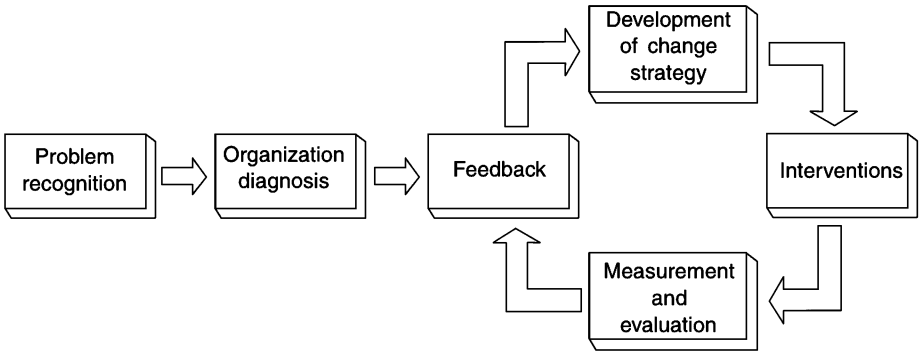
OD is a situational or contingency approach to improving enterprise effectiveness. Although various techniques are utilized, the process often involves the steps shown in Figure 13.4. An example can illustrate the application of the model.

Consider a firm that experiences certain problems: conflict between organizational units, low morale, customer complaints, and rising costs (*problem recognition* in the model). The chief executive contacts an OD expert to discuss the situation. The two agree on the necessity of an *organizational diagnosis*. The consultant then collects information from several organizational units, using questionnaires, interviews, and observation. The data are analyzed and prepared for feedback.

The executive confers with other managers to set up a meeting with them. At the meeting, after some introductory comments, the consultant presents the findings under the headings "relations between departments," "enterprise goals," and "customer relations" (*feedback*). The group then ranks the problems in order of their importance. With the guidance of the consultant, the group discusses the difficulties, identifies the underlying causes, and explores possible solutions.

**Figure 13.3**

**A Model of the Organization Development Process.**
**Adapted from H. M F. Rush, *Organizational Development: A Reconnaissance* (New York: National Industrial Conference Board, Inc., 1973) p. 6. Used by permission.**




The role of the consultant is that of a coach facilitating the process. Short lectures and exercises on decision-making, team building, and problem solving are integrated into the process. At times, subgroups are established to deal with specific issues. The emphasis is on openness and objectivity. The meeting ends with an agreement on a *change strategy*.

The specific *interventions* may include a change in the organization structure, a more effective procedure for handling customer complaints, and the establishment of a team charged with the responsibility of implementing a cost reduction program. Furthermore, the group agrees to meet again in three months to *measure and evaluate* the effectiveness of the OD efforts.

Although three phases complete the OD cycle, the effort does not end. Instead, OD becomes a continuous process—planned, systematic, and focused on change—that aims at making the enterprise more effective.

**LEADERSHIP PERSPECTIVE**

## Leading a Successful Team[15]

The position of the Chief Operating Officer (COO) is often considered a stepping stone for the top position of the Chief Executive Officer (CEO). This, however, may be changing in favor of teams that implement corporate strategy. Instead of having the COO implementing the strategy, teams may carry out this task. This would eliminate a level in the organizational hierarchy.

The chief characteristic of teams is a shared commitment to a common purpose. Team members share accountability not only to each other but also to the common aim. However, team skills have to be learned. Not all teams succeed; in fact, many fail.

What makes successful teams? Team members need to be trained in skills such as communication, including listening. They must learn about setting team objectives, staying focused, and making decisions that contribute not only to the team's goals but also to the aims of the total organization. Moreover, the reward system must be based on team performance and less on individual accomplishments. Teams also need to have access to important information (which some top managers may not want to share), thus a culture of openness is essential. Perhaps the most important attribute is that team training is not an individual event or a one-time program but a continuing process. ■■

## THE LEARNING ORGANIZATION

**Learning organization** An organization that can adapt to changes in the external environment through continuous renewal of its structure and practices.

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A learning organization is one that can adapt to changes in the external environment through continuous renewal of its structure and practices. Peter Senge, who popularized the concepts of the learning organization with his book *The Fifth Discipline*,[16] suggests five techniques that help the organization to learn: (1) systems thinking, (2) personal mastery, (3) mental models, (4) a shared vision, and (5) team learning. The learning organization is generally associated with concepts such as sharing the vision of the enterprise, self-examining the prevailing assumptions and practices, considering radically new organization structures, creating learning teams, and establishing linkages with parties outside the enterprise for generating new ideas and perspectives.

David Garvin offers the following definition: "A learning organization is an organization skilled at creating, acquiring, and transferring knowledge, and at modifying its behavior to reflect new knowledge and insights."[17] This means that organizations engage in systematic problem solving, experimenting, and continuously searching for new knowledge. There must also be tolerance for failure because experimentation may not succeed; the aim is of course to learn from past failures. The learning should not be restricted to one's own experience. One can learn a great deal from others, inside and outside the organization. Learning from other organizations is often achieved through benchmarking, which requires the search for the best practices not only within the same industry but also in other industries. What is learned needs to be shared through, for example, reports, plant tours, and education and training programs. Individuals or groups should be encouraged to share their specialized knowledge and disseminate it throughout the organization. Acquiring knowledge is not enough; knowledge has to be applied. Unless behavior is changed, little is gained from the efforts of creating a learning organization. Therefore, progress and improvement need to be measured through questionnaires, surveys, interviews, and observation of behavior. Department stores may, for example, use shoppers to assess the service of their sales assistants. Assessors at the department store L.L. Bean shop by telephone to evaluate the service of its operators. A comprehensive learning audit may include a variety of measurements.

INTERNATIONAL PERSPECTIVE

## Wal-Mart's Global Learning[18]

www.aldi.com
www.asda.co.uk
www.seiyu.co.jp/english/index.shtml
www.aeon.info/en/
www.carrefour.com/english/

When Wal-Mart's U.S. market became saturated, it needed international markets for its expansion. By 2006, its international sales accounted for some 20 percent of total sales. But the expansion abroad into some 15 countries was not without its problems – even in countries where the company was relatively successful.

- In Germany, Wal-Mart had problems with employees, customers, and the low-price competitor Aldi Einkauf GmbH. Employees objected to the policy that does not allow employees to engage in romantic relationships between supervisors and employees. Customers considered the friendly smiles by cashiers as flirting. Perhaps most important, Aldi was already well established in Germany by offering a limited number of products but at low prices. Also, certain consumers did not consider Wal-Mart's image as a low-priced leader. As of 2006, Wal-Mart was not profitable and there were rumors that Wal-Mart would leave Germany.
- In the United Kingdom, Wal-Mart's subsidiary Asda, fared better because the company was recognized for its low prices. Moreover, Asda responded to local zoning laws by opening smaller stores.
- Since 2002 Wal-Mart operated in Japan where it invested in Seiyu Ltd., a chain selling groceries and apparels. Its competitor, Aeon Co., apparently was impressed by the Wal-Mart business model that it sent its employees to China and South Korea to study the operation. On the other hand, other Japanese competitors also reduced prices and opened single-story supercenters.
- The supercenter model, however, did not work well in Brazil where consumers prefer the local market. Also, pushing golf clubs in the land of soccer was not appropriate. But Wal-Mart's Brazilian managers helped to adjust the company's approach by offering, for example, more food items in their stores.
- In China, where many consumers have limited transportation choices, Wal-Mart offered free shuttle service and home delivery for heavy items such as refrigerators. Although the market share in 2005 was only two percent, it is estimated that with an increase to three percent, it could gain $20 billions in annual sales. The company, however, faces tough competition from the French retailer Carrefour SA.
- Mexico is a very important market for Wal-Mart. It learned that ice skates are not important to the consumers. On the other hand, certain Mexicans are familiar with Wal-Mart from their experiences in the United States.
- Wal-Mart is planning for the future. Although India does not allow foreign retailers into the country, Wal-Mart is studying this market carefully to be ready if and when the restrictions will be lifted.

With international sales account for 20 percent of Wal-Mart's sales, the global market is crucial for Wal-Mart's future. Yes, mistakes have been made by not understanding the cultural environment abroad. However, Wal-Mart is learning from its mistakes because international customers are vital for its growth. ■■

## SUMMARY

Manager development refers to the progress a manager makes in learning how to manage effectively. Frequently, it also pertains to development programs. Organization development, on the other hand, is a systematic, integrated, and planned approach to making the whole organization or an organizational unit effective.

Good results can be achieved through a systematic approach to manager development and training. On-the-job training includes planned progression, job rotation, creation of "assistant-to" positions, temporary promotions, use of committees and junior boards, and coaching. Manager development may include a variety of internal and external training programs.

There are many sources of conflict. Ways of managing conflict include avoiding the situation, smoothing, forcing, compromising, changing behavior, reassigning individuals, resolving the conflict at higher levels, and problem solving. Another approach is to make structural changes: modifying objectives, developing new methods of coordination, as well as rearranging authority–responsibility relationships, tasks, and work locations.

The typical organization development process includes the recognition of problems, diagnosis of an organization, feedback of information on the organization, development of a change strategy, interventions, and measurement and evaluation of the change efforts. The learning organization adapts quickly to changes in the environment through continuous learning.



## KEY IDEAS AND CONCEPTS FOR REVIEW

- ✔ Manager development
- ✔ Managerial training
- ✔ Organization development
- ✔ Manager development process
- ✔ On-the-job training
- ✔ Internal and external training and development
- ✔ Business simulation and experiential exercises
- ✔ E-training
- ✔ Field force theory
- ✔ Sources of organizational conflict
- ✔ Ways of managing organizational conflict
- ✔ Organization development process
- ✔ Learning organization

## FOR DISCUSSION

1. It has been argued that firms have an obligation to train and develop all employees with managerial potential. Do you agree? Why or why not?
2. What are some typical failures in manager development and training? Can you explain these failures? What would you recommend to overcome the shortcomings?
3. Evaluate the advantages and limitations of different approaches to on-the-job training.
4. In the job that you now have or that you expect to have in future, what kind of coaching and management development would be most beneficial to you?
5. What are the main characteristics of organization development? How does organization development differ from manager development? Do you think organization development might work in your organization? Explain why or why not.

## EXERCISES/ACTION STEPS

1. Select an organization that you know and analyze its management development efforts.
2. What kinds of conflicts have you experienced in an organization with which you are familiar? What were the causes of the conflicts? What was done, if anything, about resolving these conflicts?

## INTERNET RESEARCH

1. Search the Internet for "open university." What are the advantages and disadvantages of the Open University? Compare the Open University with the traditional university.
2. Search for "organization development" on the Internet. Discuss your findings with the class.

**Leadership Case**

## Jack Welch Leading Organizational Change at GE[19]

When Jack Welch, the chairman and CEO at General Electric (GE) retired in 2001, he could look back at a very successful career. He became CEO in 1981 at the age of 45. At that time, GE had a very complex organization structure with considerable bureaucratic rules.

One of his first changes was to initiate a strategy formulation process with the guideline that each of the businesses should be number 1 or 2 in their respective areas. If this was not the case, managers had the options of fixing the problem, selling their particular business, or closing it. In an effort to streamline the organization, Welch removed the sector level and eliminated thousands of salaried and hourly employee positions. Because of these drastic measures, he earned

the nickname "Neutron Jack." The reorganization increased the span of management (also called span of control) for many managers so that they would have 10 or even 15 subordinates.

The restructuring was followed by changing the organization culture and the managerial styles of GE's managers. One such program was the Work-Out. Groups of managers were assembled to share their views openly in three-day sessions. At the beginning of the meetings, the superior presented the challenges for his or her organizational unit. Then the superior had to leave, requesting the groups to find solutions to the problems. Facilitators helped these discussions. On the last day, the superior was presented with problem solutions. He or she then had three choices: to accept the proposal, not to accept it, or to collect more information. This process put great pressure on the superior to make decisions.

Another program to improve effectiveness and efficiency was Best Practices. The aim was to learn from other companies how they obtained customer satisfaction, how they related to their suppliers, and in what ways they developed new products. This helped the GE people to focus on the processes in their operations that would improve the company's performance.

Jack Welch was personally involved in developing managers at GE's training center in Crotonville. Leaders, Welch suggested, are not only those who achieve results but also those who share the values of the company. Managers who shared the company values but did not achieve results got another opportunity to improve performance, while managers who achieved results but did not share the values received coaching aimed at changing their value orientation. There was little hope for managers who did not achieve results nor shared the company's values.

The stretch initiative at GE emphasized "dream targets" with little consideration of how to achieve them. This approach is similar to the setting of creative objectives used in some management-by-objectives programs by other companies. These dream targets did not replace the traditional objective-setting approach but supplemented it.

To improve quality, the Six Sigma approach, which was used by Motorola, was introduced at GE. The Six Sigma program suggests a quality level of not more than 3.4 defects for a million operations. Managers were required to participate in the program, and their bonuses were related to the achievement of the quality level. With the strong conviction of relating performance to rewards, an appraisal system was also introduced that ranked employees in five categories ranging from the top 10 percent to the bottom 10 percent. The top 25 percent received stock options as their reward.

While some managers were in favor of the organizational transformation because they felt greater freedom and were rewarded for good performance and value sharing, others saw flaws in the system.

**Questions**

1. Do you think it is ethical to engage in restructuring and delayering that result in massive reduction of positions?
2. How would you feel if you were the boss in the work-out session being asked to leave the meeting while your subordinates discuss problems and suggest solutions to which you have to say "yes," "no," or "require further study"?
3. Why would other companies agree to their best practices being studied?
4. What do you think of evaluating the performance of managers not only on the achievement of results but also on the degree to which they share the organizational values?
5. How would you feel about setting unrealistic (stretch) objectives?

6. Should managers be ranked within their organizational unit? What would you suggest if one such unit is far superior to another unit with most of its managers being generally good managers and yet you still have to identify the bottom 10 percent?
7. Overall, how would you evaluate GE's approach to organizational change? What are the advantages and possible problems?

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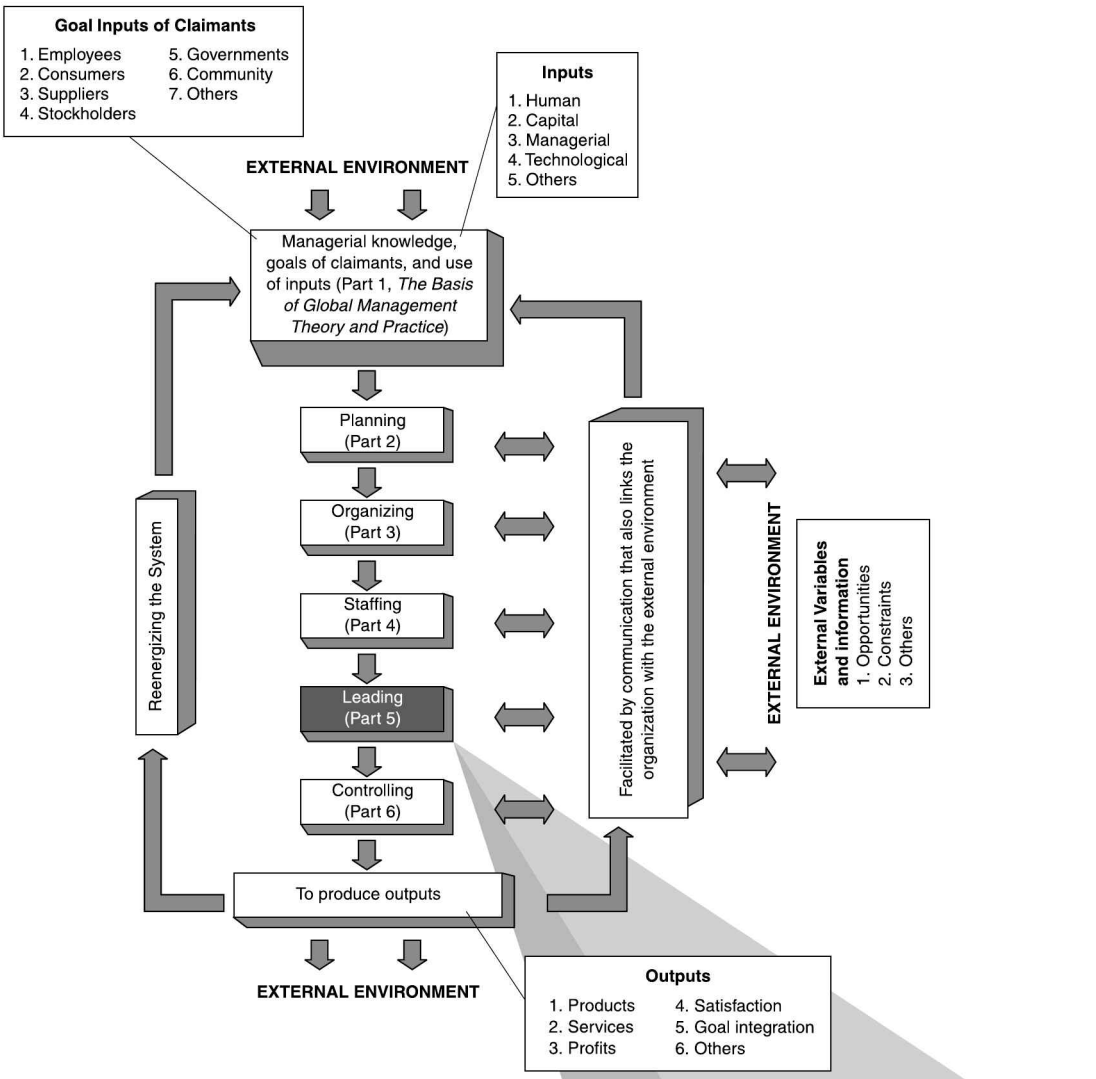


## SYSTEMS APPROACH TO MANAGEMENT: LEADING

Part 5

14. Human Factors and Motivation
15. Leadership
16. Committees, Teams, and Group Decision-Making
17. Communication

# 14 Human Factors and Motivation

## Chapter Objectives

After studying this chapter, you should be able to:

- Define the nature of leading and leadership
- Describe the basic human factors that affect managing
- Explain the meaning of motivation
- Describe the various theories of motivation and their strengths and weaknesses
- Analyze motivational techniques, with emphasis on the role of money, participation, the quality of working life, and job enrichment
- Present a systems and situational approach to motivation

Management and leadership are often thought of as the same thing. Although it is true that the most effective manager will almost certainly be an effective leader and that leading is an essential function of managers, there is more to managing than just leading. As indicated in previous chapters, managing involves doing careful planning, setting up an organization structure that will aid people in achieving goals, and staffing the organization structure with people who are as competent as possible. The measurement and correction of people's activities through controlling is also an important function of management, as Part 6 will show. However, all these managerial functions accomplish little if managers do not know how to lead people or understand the human factors in their operations in such a way as to produce desired results.

**Leading** The process of influencing people so that they will contribute to organizational and group goals.

The managerial function of **leading** is defined as the process of influencing people so that they will contribute to organizational and group goals. As the discussion of this function will show, it is in this area that the behavioral sciences make their major contribution to managing. In its analysis of the pertinent knowledge in leading, Part 5 of this book will focus on the human factors, motivation, leadership, and communication.

Managing requires the creation and maintenance of an environment in which individuals work together toward the accomplishment of common objectives.

In this chapter, discussion centers on a variety of human factors. Managing requires the creation and maintenance of an environment in which individuals work together in groups toward the accomplishment of common objectives. This chapter emphasizes the importance of knowing and taking advantage of human and motivating factors, but that does not mean managers should become amateur

psychiatrists. The manager's job is not to manipulate people but, rather, to recognize what motivates people.

## HUMAN FACTORS IN MANAGING

It is obvious that, while enterprise objectives may differ somewhat between organizations, employees also have needs and objectives that are especially important to them. Through the function of leading, managers help people see that they can satisfy their own needs and utilize their potential while contributing to the aims of an enterprise. Managers should thus have an understanding of the roles assumed by people and the individuality and personalities of people.

### Multiplicity of Roles

Individuals are much more than a productive factor in management's plans. They are members of social systems of many organizations; they are consumers of goods and services, and thus they vitally influence demand; and they are members of families, schools, churches, trade associations, and political parties. In these different roles, they establish laws that govern managers, ethics that guide behavior, and a tradition of human dignity that is a major characteristic of our society. In short, managers and the people they lead are interacting members of a broad social system.

### No Average Person

People act in different roles, but they are also different themselves. There is no average person. Yet, in organized enterprises, the assumption is often made that there is. Firms develop rules, procedures, work schedules, safety standards, and position descriptions—all with the implicit assumption that people are essentially alike. Of course, this assumption is necessary to a great extent in organized efforts, but it is equally important to acknowledge that individuals are unique—they have different needs, different ambitions, different attitudes, different desires for responsibility, different levels of knowledge and skills, and different potentials.

Unless managers understand the complexity and individuality of people, they may misapply the generalizations about motivation, leadership, and communication. Principles and concepts, although generally true, have to be adjusted to fit specific situations. In an enterprise, not all the needs of individuals can be completely satisfied, but managers do have considerable latitude in making individual arrangements. Although position requirements are usually derived from enterprise and organization plans, this fact does not necessarily exclude the possibility of arranging the job to fit the person in a specific situation.

**Concept of individual dignity** People must be treated with respect, no matter what their position in the organization.

### The Importance of Personal Dignity

Managing involves achieving enterprise objectives. Achieving results is important, but the means must never violate the dignity of people. The **concept of individual dignity** means that people must be treated with respect, no matter what their posi-

tion in the organization. The president, vice president, manager, first-line supervisor, and worker—all contribute to the aims of the enterprise. Each is unique, with different abilities and aspirations, but all are human beings and all deserve to be treated as such.[1]

### Consideration of the Whole Person

We cannot talk about the nature of people unless we consider the whole person, not just separate and distinct characteristics such as knowledge, attitude, skills, or personality traits. A person has them all in different degrees. Moreover, these characteristics interact with one another, and their predominance in specific situations changes quickly and unpredictably. The human being is a total person influenced by external factors. People cannot divest themselves of the impact of these forces when they come to work. Managers must recognize these facts and be prepared to deal with them.

**INTERNATIONAL PERSPECTIVE**

#### Disillusioned Middle Managers[2]

The recent trend of downsizing organizations and the merger of enterprises has had a traumatic effect on middle managers in many organizations. In the drive to improve efficiency, many middle-level manager jobs have been eliminated. The drastic reduction in personnel in many U.S. enterprises has had unexpected consequences. For example, it was assumed that the working life of the remaining managers would be enriched by more meaningful jobs. The reality is that many managers now feel that they are overworked and that their contributions go unappreciated.

The restructuring of organizations has resulted in great job insecurity and low morale. Managers are often reluctant to share information because they want to protect their jobs. Moreover, they hesitate to speak freely in meetings because they do not want to risk crossing their boss. Middle managers feel that they do not get sufficient information from top managers, who often do not provide vision and leadership to the enterprise.

Whatever the situation, the bitterness and alienation of many lower-level managers affect morale and productivity. If companies want to be competitive, employees must be committed to enterprise goals. To elicit this dedication requires corporate concern for the individual, recognition of his or her dignity as a human being, and reasonable job security with an opportunity for personal growth and development.

## MOTIVATION

Human motives are based on needs, whether consciously or subconsciously felt. Some are primary needs, such as the physiological needs for water, air, food, sleep,

and shelter. Other needs may be regarded as secondary, such as self-esteem, status, affiliation with others, affection, giving, accomplishment, and self-assertion. Naturally, these needs vary in intensity and over time between individuals.

**Motivation** A general term applying to the entire class of drives, desires, needs, wishes, and similar forces.

**Motivation** is a general term applying to the entire class of drives, desires, needs, wishes, and similar forces. To say that managers motivate their subordinates is to say that they do things which they hope will satisfy these drives and desires and induce the subordinates to act in a desired manner.

LEADERSHIP PERSPECTIVE

### Self-motivating Leaders

Managers are responsible for providing an environment conducive to performance. Individuals, however, are themselves responsible for self-motivation. One approach is through strategic career management (which was discussed in Chapter 12). George Odiorne, a management professor, scholar, and experienced consultant, made specific recommendations for motivating yourself. Here are some:

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- Set a goal for yourself and do not lose sight of it. Lee Iacocca (former president of Chrysler) set the goal of becoming vice president at Ford Motor Company by age 35 and for 15 years this aim motivated him and guided his behavior.
- Supplement your long-term objectives with short-term goals and specific actions. It has been said that to get something done is to begin.
- Learn a challenging new task each year. Learning to become a manager does not stop with a bachelor's or master's degree in business. A degree is the real beginning, not the end, of learning. Learning and applying microcomputer technology might be considered a challenging task.
- Make your job a different one. Set improvement objectives for your position. With some imagination, you probably can considerably increase your productivity.
- Develop an area of expertise. Build on your strengths or develop one of your weaknesses into strength. You might want to be known as the best accountant or the best engineer in your specific area of competence.
- Give yourself feedback and reward yourself. Setting verifiable goals provides you with a standard against which you can measure your performance. Why not have a special dinner to celebrate your accomplishments?



## AN EARLY BEHAVIORAL MODEL: MCGREGOR'S THEORY X AND THEORY Y

**McGregor's Theory X and Theory Y** Two sets of assumptions about the nature of people.

One view about the nature of people has been expressed by Douglas McGregor in his Theory X and Theory Y.[3] Managing, McGregor suggests, must start with the basic question of how managers see themselves in relation to others. This viewpoint requires some thought on the perception of human nature. Theories X and Y are two sets of assumptions about the nature of people. McGregor chose these terms

because he wanted neutral terminology without any connotation of being "good" or "bad."

## Theory X Assumptions

The "traditional" assumptions about the nature of people, according to McGregor, are included in Theory X as follows:

- Average human beings have an inherent dislike of work and will avoid it if they can.
- Because of this human characteristic of disliking work, most people must be coerced, controlled, directed, and threatened with punishment to get them to put forth adequate effort toward the achievement of organizational objectives.
- Average human beings prefer to be directed, wish to avoid responsibility, have relatively little ambition, and want security above everything else.

## Theory Y Assumptions

McGregor sees the assumptions under Theory Y as follows:

- The expenditure of physical and mental effort in work is as natural as play or rest.
- External control and the threat of punishment are not the only means for producing effort toward organizational objectives. People will exercise self-direction and self-control in the service of objectives to which they are committed.
- The degree of commitment to objectives is in proportion to the size of the rewards associated with their achievement.
- Average human beings learn, under proper conditions, not only to accept responsibility but also to seek it.
- The capacity to exercise a relatively high degree of imagination, ingenuity, and creativity in the solution of organizational problems is widely, not narrowly, distributed in the population.
- Under the conditions of modern industrial life, the intellectual potentialities of the average human being are only partially utilized.

These two sets of assumptions obviously are fundamentally different. Theory X is pessimistic, static, and rigid. Control is primarily external, imposed on the subordinate by the superior. In contrast, Theory Y is optimistic, dynamic, and flexible, with an emphasis on self-direction and the integration of individual needs with organizational demands. There is little doubt that each set of assumptions will affect the way managers carry out their managerial functions and activities.

## Clarification of the Theories

McGregor was apparently concerned that Theory X and Theory Y might be misinterpreted. The following points will clarify some of the areas of misunderstanding and keep the assumptions in proper perspective. First, theories X and Y assumptions are just that: they are assumptions only. They are not prescriptions or suggestions for managerial strategies. Rather, these assumptions must be tested against reality. Furthermore, they are intuitive deductions and are not based on research. Second,

theories X and Y do not imply "hard" or "soft" management. The "hard" approach may produce resistance and antagonism. The "soft" approach may result in laissez-faire management and is not congruent with Theory Y. The effective manager recognizes the dignity and capabilities, as well as the limitations of people, and adjusts behavior as demanded by the situation. Third, theories X and Y are not to be viewed as being on a continuous scale, with X and Y on opposite extremes. They are not a matter of degree; rather, they are completely different views of people.

Fourth, the discussion of Theory Y is not a case for consensus management, nor is it an argument against the use of authority. Under Theory Y, authority is seen as only one of the many ways a manager exerts leadership. Fifth, the variety of tasks and situations requires different approaches to management. At times, authority and structure may be effective for certain tasks, as found in the research by John J. Morse and Jay W. Lorsch.[4] They suggest that different approaches are effective in different situations. Thus, the productive enterprise is one that fits the task requirements to the people and the particular situation. We shall describe in the following section various theories of motivation.

## MASLOW'S HIERARCHY OF NEEDS THEORY

**Maslow's needs theory** When one set of needs is satisfied, this kind of need ceases to be a motivator.

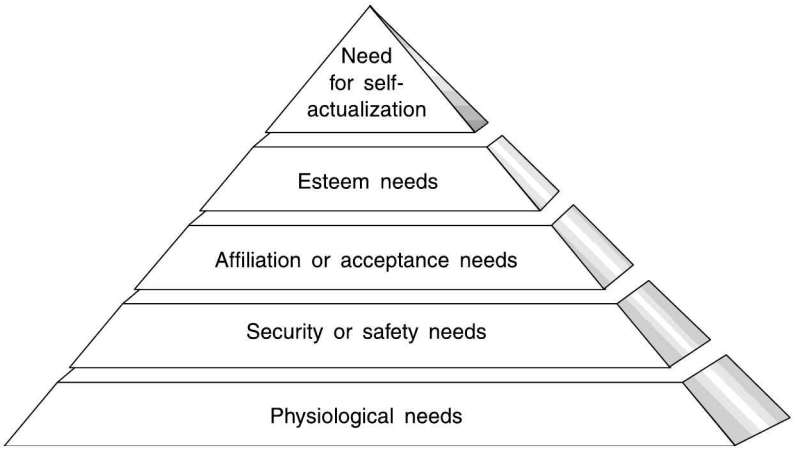
One of the most widely mentioned theories of motivation is the hierarchy of needs theory put forth by psychologist Abraham Maslow.[5] Maslow saw human needs in the form of a hierarchy, ascending from the lowest to the highest; and he concluded that, when one set of needs is satisfied, this kind of need ceases to be a motivator.

### The Needs Hierarchy

The basic human needs placed by Maslow in an ascending order of importance and shown in Figure 14.1 are:

1. *Physiological needs*. These are the basic needs for sustaining human life itself, such as food, water, warmth, shelter, and sleep. Maslow took the position that, until these needs are satisfied to the degree necessary to maintain life, other needs will not motivate people.
2. *Security, or safety, needs*. People want to be free of physical danger and of the fear of losing a job, property, food, or shelter.
3. *Affiliation, or acceptance, needs*. Since people are social beings, they need to belong, to be accepted by others.
4. *Esteem needs*. According to Maslow, once people begin to satisfy their need to belong, they tend to want to be held in esteem both by themselves and by others. This kind of need produces such satisfactions as power, prestige, status, and self-confidence.
5. *Need for self-actualization*. Maslow regards this as the highest need in his hierarchy. It is the desire to become what one is capable of becoming—to maximize one's potential and to accomplish something.

**Figure 14.1**
**Maslow's Hierarchy of Needs.**




## Questioning the Needs Hierarchy

Maslow's concept of a hierarchy of needs has been subjected to considerable research. Edward Lawler and J. Lloyd Suttle collected data on 187 managers in two different organizations over a period of 6 to 12 months.[6] They found little evidence to support Maslow's theory that human needs form a hierarchy. They did note, however, that there are two levels of needs—biological and other needs—and that the other needs would emerge only when biological needs are reasonably satisfied. They found further that at the higher level the strength of needs varies with the individual: in some individuals social needs predominate, while in others self-actualization needs are strongest.

In another study of Maslow's needs hierarchy involving a group of managers over a period of five years, Douglas T. Hall and Khalil Nougaim did not find strong evidence of a hierarchy.[7] They found that, as managers advance in an organization, their physiological and safety needs tend to decrease in importance, while their needs for affiliation, esteem, and self-actualization tend to increase. They insisted, however, that the upward movement of need prominence results from upward career changes and not from the satisfaction of lower-order needs.

# ALDERFER'S ERG THEORY

**Alderfer's ERG theory** People are motivated by existence needs, relatedness needs, and growth needs.

The ERG theory by Clayton Alderfer is similar to Maslow's hierarchy of needs. However, the ERG theory has only three categories: existence needs (similar to Maslow's basic needs), relatedness needs (pertaining to satisfactorily relating to others), and growth needs (referring to self-development, creativity, growth, and competence).[8] Thus, ERG refers to those three categories of existence, relatedness, and growth. Alderfer suggests that one may be motivated by needs on several levels at the same time. For example, one may go to work to make a living (existence needs satisfac-

tion), and at the same time, one may be motivated by good relations with coworkers. Also, according to Alderfer, when people experience frustration on one level, they may focus on the needs at a lower-level needs category.

## HERZBERG'S MOTIVATION–HYGIENE THEORY

**Herzberg's two-factor theory** Dissatisfiers, also called maintenance, hygiene, or job-context factors, are not motivators, while satisfiers are motivators and are related to job content.

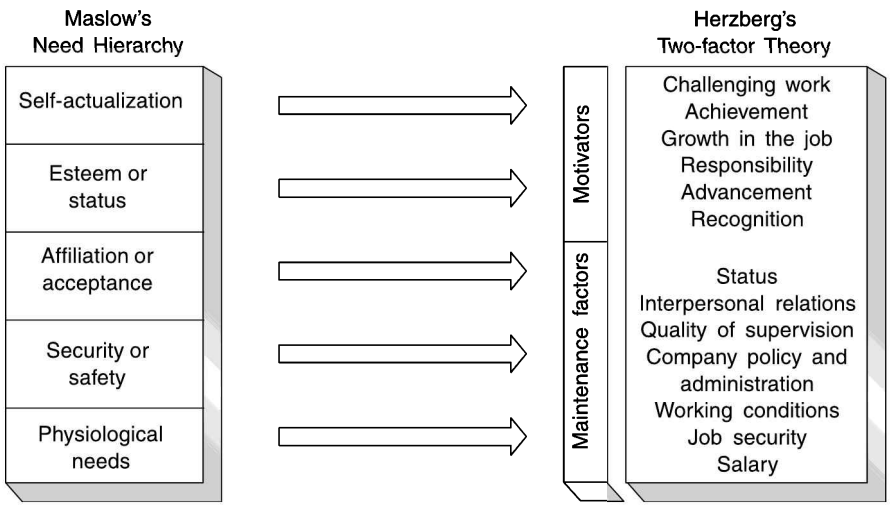
Maslow's needs approach has been considerably modified by Frederick Herzberg and his associates.[9] Their research purports to find a **two-factor theory** of motivation. In one group of needs are such things as company policy and administration, supervision, working conditions, interpersonal relations, salary, status, job security, and personal life. These were found by Herzberg to be only *dissatisfiers* and not motivators. In other words, if they exist in a work environment in high quantity and quality, they yield no dissatisfaction. Their existence does not motivate in the sense of yielding satisfaction; their lack of existence would, however, result in dissatisfaction. Herzberg calls them *maintenance, hygiene, or job-context factors*.

In the second group, Herzberg lists certain *satisfiers*—and therefore motivators—all related to *job content*. They include achievement, recognition, challenging work, advancement, and growth in the job. Their existence will yield feelings of satisfaction or no satisfaction (not dissatisfaction). As Figure 14.2 indicates, the satisfiers and dissatisfiers identified by Herzberg are similar to the factors suggested by Maslow.

The first group of factors (the dissatisfiers) will not motivate people in an organization; yet they must be present, or dissatisfaction will arise. The second group, or the job-content factors, was found to be the real motivators because they have the potential of yielding a sense of satisfaction. Clearly, if this theory of motivation is sound, managers must give considerable attention to upgrading job content.

**Figure 14.1**

**Comparison of Maslow's and Herzberg's Theories of Motivation.**



The Herzberg research has not gone unchallenged. Some researchers have questioned Herzberg's investigation methods, which they said tended to prejudice the results. For example, the well-known tendency of people to attribute good results to their own efforts and to blame others for poor results is thought to have prejudiced Herzberg's findings. Other researchers, not following his methods, have arrived at conclusions that do not support the theory.

## THE EXPECTANCY THEORY OF MOTIVATION

**Vroom's expectancy theory** People will be motivated to do things to reach a goal if they believe in the worth of that goal and if they can see that what they do will help them in achieving it.

Another approach, one that many believe goes far in explaining how people are motivated, is the expectancy theory. One of the leaders in advancing and explaining this theory is the psychologist Victor H. Vroom. He holds that people will be motivated to do things to reach a goal if they believe in the worth of that goal and if they can see that what they do will help them in achieving it.[10] In a sense, this is a modern expression of what the German priest Martin Luther observed centuries ago when he said, "Everything that is done in the world is done by hope."

In greater detail, Vroom's theory is that people's motivation toward doing anything will be determined by the value they place on the outcome of their effort (whether positive or negative) multiplied by the confidence they have that their effort will materially aid in achieving a goal. In his own terms, Vroom's theory may be stated as

$$\text{Force} = \text{Valence} \times \text{Expectancy}$$

where *force* is the strength of a person's motivation, *valence* is the strength of an individual's preference for an outcome, and *expectancy* is the probability that a particular action will lead to a desired outcome. When a person is indifferent about achieving a certain goal, a valence of zero occurs; there is a negative valence when the person would rather not achieve the goal. The result of either would be, of course, no motivation. Likewise, a person would have no motivation to achieve a goal if the expectancy were zero or negative. The force exerted to do something will depend on *both* valence and expectancy. Moreover, a motive to accomplish some action might be determined by a desire to accomplish something else. For example, a person might be willing to work hard to produce a product for a valence in the form of pay. Or a manager might be willing to work hard to achieve company goals in marketing or production for a promotion or pay valence.

### The Vroom Theory and Practice

One of the great attractions of the Vroom theory is that it recognizes the importance of individual needs and motivations. It thus avoids some of the simplistic features of the Maslow and Herzberg approaches. It does seem more realistic. It fits the concept of harmony of objectives: individuals have personal goals that are different from organizational goals, but these can be harmonized. Furthermore, Vroom's theory is completely consistent with the system of managing by objectives.

The strength of Vroom's theory is also its weakness. His assumption that perceptions of value vary between individuals at different times and in different places appears to fit real life more accurately. It is consistent also with the idea that a

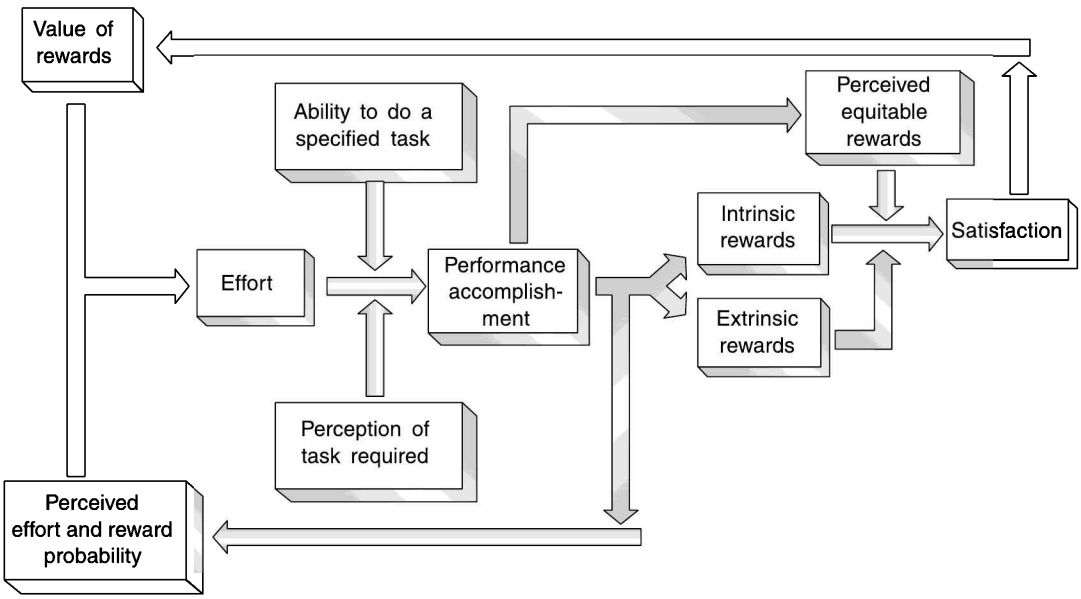
manager's job is to *design* an environment for performance, necessarily taking into account the differences in various situations. On the other hand, the theory is difficult to apply in practice. Despite its difficulty in application, the logical accuracy of Vroom's theory indicates that motivation is much more complex than the approaches of Maslow and Herzberg seem to imply.

## The Porter and Lawler Motivation Model

Lyman W. Porter and Edward E. Lawler derived a substantially more complete model of motivation, built in large part on expectancy theory. In their study, they applied this model primarily to managers.[11] It is summarized in Figure 14.3.

**Figure 14.1**

**Porter and Lawler's Motivation Model.**
**Adapted from L. W. Porter and E. E. Lawler, *Managerial Attitudes and Performance* (Homewood, Ill: Richard D. Irwin, Inc., 1968), p. 165.**




As this model indicates, the amount of effort (the strength of motivation and energy exerted) depends on the value of a reward plus the amount of energy a person believes is required and the probability of receiving the reward. The perceived effort and probability of actually getting a reward are in turn influenced by the experience of actual performance. Clearly, if people know they can do a job or if they have done it, they have a better appreciation of the effort required and know better the probability of getting a reward.

Actual performance in a job (the doing of tasks or the meeting of goals) is determined principally by effort expended. But it is also greatly influenced by an

individual's ability (knowledge and skills) to do the job and by his or her perception of what the required task is (the extent to which the person understands the goals, required activities, and other elements of a task). Performance, in turn, is seen as leading to intrinsic rewards (such as a sense of accomplishment or self-actualization) and extrinsic rewards (such as working conditions and status). These rewards, tempered by what the individual sees as equitable, lead to satisfaction. Performance too, however, influences sensed equitable rewards. Understandably, what the individual sees as a fair reward for effort will necessarily affect the satisfaction derived. Likewise, the actual value of rewards will be influenced by satisfaction.

### Implications for Practice

While more complex than other theories of motivation, the Porter and Lawler model of motivation is almost certainly a more adequate portrayal of the system of motivation. To the practicing manager, this model means that motivation is not a simple cause and effect matter. It also means that managers should carefully assess their reward structures. Through careful planning, managing by objectives, and clearly defining duties and responsibilities through a good organization structure, the effort–performance–reward–satisfaction system can be integrated into an entire system of managing.

## EQUITY THEORY

**Equity theory** Motivation is influenced by an individual's subjective judgment about the fairness of the reward he or she gets, relative to the inputs, compared with the rewards of others.

An important factor in motivation is whether individuals perceive the reward structure as being fair. One way of addressing this issue is through the use of equity theory, which refers to an individual's subjective judgment about the fairness of the reward he or she gets, relative to the inputs (which include many factors, such as effort, experience, and education), in comparison with the rewards of others, J. Stacy Adams has received a great deal of credit for the formulation of the equity (or inequity) theory.[12] The essential aspect of the theory may be expressed as follows:

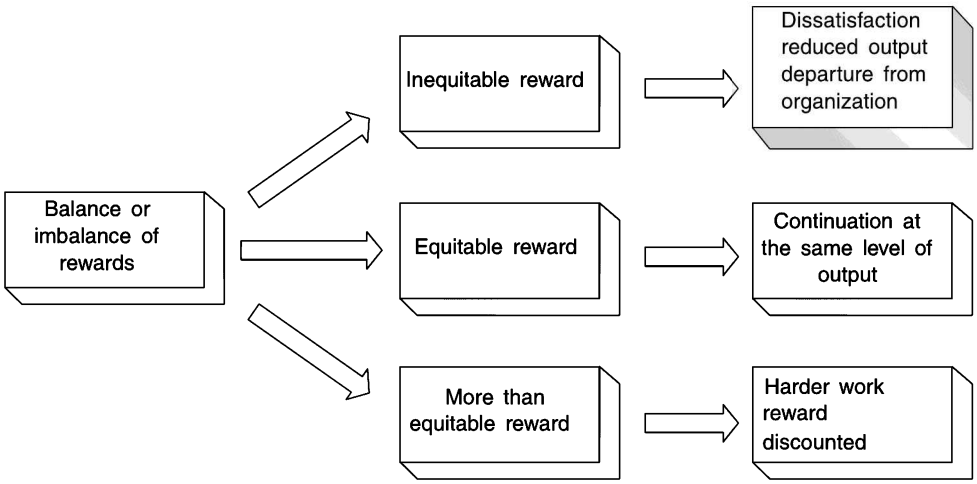
$$\frac{\text{Outcomes by a person}}{\text{Inputs by a person}} = \frac{\text{Outcomes by another person}}{\text{Inputs by another person}}$$

There should be a balance of the outcomes/inputs relationship for one person in comparison with that for another person.

If people feel that they are inequitably rewarded, they may be dissatisfied, they may reduce the quantity or quality of output, or they may even leave the organization. If people perceive the rewards as equitable, they probably will continue at the same level of output. If people think the rewards are greater than what is considered equitable, they may work harder. It is also possible that some may discount the rewards. These three situations are illustrated in Figure 14.4.

One of the problems is that people may overestimate their own contributions and the rewards others receive. Certain inequities may be tolerated for some time by employees.[13] But prolonged feelings of inequity may result in strong reactions to an apparently minor occurrence. For example, an employee being reprimanded for being a few minutes late may get angry and decide to quit the job, not so much

**Figure 14.1**
**Equity Theory.**




because of the reprimand but because of long-standing feelings that the rewards for his or her contributions are inequitable in comparison with others' rewards. Likewise, a person may be very satisfied with a weekly salary of $500 until he or she finds out that another person doing similar work gets $10 more.

## GOAL SETTING THEORY OF MOTIVATION[14]

In Chapter 4, the systems approach to management by objectives (MBO) was introduced. The model shown in Figure 4.4 in that chapter shows a comprehensive view of MBO. Research has shown that, to be effective, many key managerial activities have to be integrated into a comprehensive system. Still, an important part of this system pertains to the steps required, of setting objectives, planning actions, implementation, and control and appraisal, as shown in Figure 14.5. You will recall that the terms *objectives* and *goals* are often used interchangeably in the management literature.

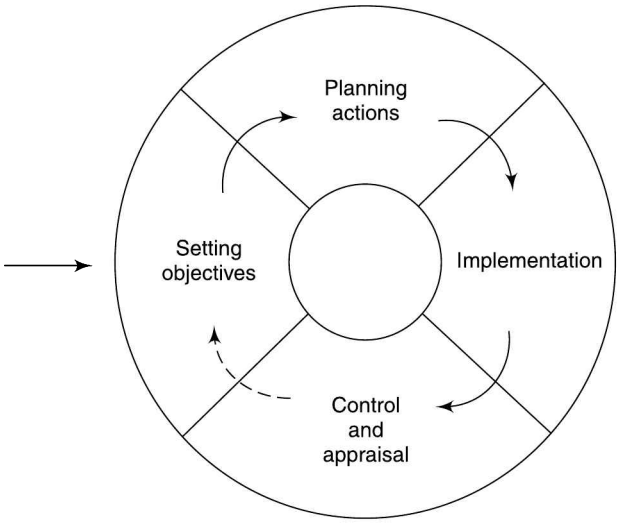
For objectives to be meaningful, they must be clear, attainable, and verifiable.

The proposition is that, for objectives to be meaningful, they must be clear, attainable, and verifiable. Indeed, clear goals, if accepted, are motivating. People want to know what is expected of them. However, several conditions must be met, including that the objectives must be verifiable, which means that at the end of the period, one must be able to measure whether the objectives have been achieved and to what extent. Objectives such as "getting the best grades possible in school" are not verifiable, but graduating with a 3.8 grade point average is. The objectives must be challenging, yet they must also be reasonable. Completely unrealistic objectives that cannot be achieved are demotivating rather than motivating, which is an important aim of MBO.

To gain commitment to achieving the goals, true participation in setting them is essential. In the proper environment, individuals should be encouraged to set them

**Figure 14.1**

**Objective or Goal Setting for Motivation.**




by themselves. The superior, of course, should review and approve them. Chances are that, in the proper environment, people tend to set goals higher than their superior would set them.

For additional conditions for effective goal setting that improve motivation, see the checklist in Table 4.2 in Chapter 4.

## SKINNER'S REINFORCEMENT THEORY

**Positive reinforcement or behavior modification** Individuals can be motivated by proper design of their work environment and by praise for their performance, while punishment for poor performance produces negative results.

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The psychologist B. F. Skinner of Harvard developed an interesting, but controversial, technique for motivation. This approach, called **positive reinforcement** or **behavior modification**,[15] holds that individuals can be motivated by proper design of their work environment and by praise for their performance and that punishment for poor performance produces negative results.

Skinner and his followers do far more than praise good performance. They analyze the work situation to determine what causes workers to act the way they do, and then they initiate changes to eliminate troublesome areas and obstructions to performance. Specific goals are then set with workers' participation and assistance, prompt and regular feedback of results is made available, and performance improvements are rewarded with recognition and praise. Even when performance does not equal goals, ways are found to help people and to praise them for the good things they do. It has also been found highly useful and motivating to give people full information on a company's problems, especially those in which they are involved.

This technique sounds almost too simple to work, and many behavioral scientists and managers are skeptical about its effectiveness. However, a number of prominent companies have found the approach beneficial. Emery Air Freight Corporation, for

example, observed that this approach saved the company a substantial amount of money by merely inducing employees to take great pains to ensure that containers were properly and fully filled with small packages before shipment.

Perhaps the strength of the Skinner approach is that it is so closely akin to the requirements of good managing. It emphasizes removal of obstructions to performance, careful planning and organizing, control through feedback, and the expansion of communication.

## MCCLELLAND'S NEEDS THEORY OF MOTIVATION

**McClelland's needs theory** The basic motivating needs are the need for power, the need for affiliation, and the need for achievement.

David C. McClelland has contributed to the understanding of motivation by identifying three types of basic motivating needs.[16] He classifies them as the need for power, need for affiliation, and need for achievement. Considerable research has been done on methods of testing people with respect to these three types of needs, and McClelland and his associates have done substantial research, especially on the need for achievement.

All three drives—power, affiliation, and achievement—are of particular relevance to management, since all must be recognized to make an organized enterprise work well.

### Need for Power

McClelland and other researchers have found that people with a high need for power have a great concern with exercising influence and control. Such individuals generally are seeking positions of leadership; they are frequently good conversationalists, though often argumentative; they are forceful, outspoken, hardheaded, and demanding; and they enjoy teaching and public speaking.

### Need for Affiliation

People with a high need for affiliation usually derive pleasure from being loved and tend to avoid the pain of being rejected by a social group. As individuals, they are likely to be concerned with maintaining pleasant social relationships, to enjoy a sense of intimacy and understanding, to be ready to console and help others in trouble, and to enjoy friendly interaction with others.



### Need for Achievement[17]

People with a high need for achievement have an intense desire for success and an equally intense fear of failure. They want to be challenged, and they set moderately difficult (but not impossible) goals for themselves. They take a realistic approach to risk; they are not likely to be gamblers but, rather, prefer to analyze and assess problems, assume personal responsibility for getting a job done, and like specific and prompt feedback on how they are doing. They tend to be restless, like to work long hours, do not worry unduly about failure if it does occur, and tend to like to run their own shows.

### How McClelland's Approach Applies to Managers

In research studies by McClelland and others, entrepreneurs—people who start and develop a business or some other enterprise—showed very high need-for-achievement and fairly high need-for-power drives but were quite low in their need for affiliation. Managers generally showed high on achievement and power and low on affiliation, but not as high or as low as entrepreneurs.

McClelland found the pattern of achievement motivation clearest in people in small companies, with the president normally having very high achievement motivation. In large companies, what is quite interesting is that he found chief executives to be only average in achievement motivation and often stronger in power and affiliation drives. Managers in the upper-middle level of management in such companies rated higher than their presidents in achievement motivation. Perhaps, as McClelland indicated, these scores are understandable. The chief executive has "arrived," while those below are striving to advance.

The question is often raised as to whether all managers should rate high on achievement motivation. People who do rate high tend to advance faster than those who do not. But because so much of managing requires other besides achievement drive, every company should probably have many managers who, while possessing fairly strong achievement motivation, also have a high need for affiliation. This latter need is important for working with people and for coordinating the efforts of individuals working in groups.

**LEADERSHIP PERSPECTIVE**

### Leadership Characteristics of Inspiring Leaders[18]

In a recent research on communication, seven characteristics of inspiring and motivating leaders were identified. These leaders:

- Showed enthusiasm constantly
- Had clear vision and articulated a compelling action course
- Communicated the benefits of the selected course
- Told memorable stories
- Invited followers to participate
- Inspired with an optimistic outlook
- Encouraged people to use their potential

While these characteristics are important for the leaders, they also must be flexible to adjust behavior suitable for the followers as well as the specific situation.

## SPECIAL MOTIVATIONAL TECHNIQUES

After looking at the theories of motivation, one may well ask what they mean to managers. What motivational techniques can managers use? While motivation is so

complex and individualized that there can be no single best answer, some of the major motivational techniques can be identified.

## Money[19]

Money is often more than monetary value; it can also mean status or power, or other things.

Money can never be overlooked as a motivator. Whether in the form of wages, piecework (getting paid for units produced at a certain quality level) or any other incentive pay, bonuses, stock options, company-paid insurance, or any of the other things that may be given to people for performance, money is important. And as some writers have pointed out, money is often more than monetary value; it can also mean status or power, or other things.

Economists and most managers have tended to place money high on the scale of motivators, while behavioral scientists tend to place it low. Probably neither view is right. But if money is to be the kind of motivator that it can and should be, managers must remember several things.

First, money, as money, is likely to be more important to people who are raising a family, for example, than to people who have "arrived" in the sense that their financial needs are not so urgent. Money is an urgent means of achieving a minimum standard of living, although this minimum has a way of getting higher as people become more affluent. An individual who was once satisfied with a small house and a low-priced car may now be able to derive the same satisfaction only from a large and comfortable house and a fairly luxurious automobile. And yet it is impossible to generalize in even these terms. For some people money will always be of the utmost importance, while for others it may never be.

LEADERSHIP PERSPECTIVE

### The Other Side of the Coin

The lure of money and power can lead to inappropriate and illegal actions. Ivan F. Boesky was accused of insider trading that resulted in huge personal profits—and a $100 million fine. The scandal, one of the worst on Wall Street since the 1920s, shook public confidence with the fear that stock trading may be rigged.[20] While money is often used for motivating, it also addresses itself to human greed, which dulls the conscience and may result in unethical and illegal behavior.



Second, it is probably quite true that in most kinds of businesses and other enterprises, money is used as a means of keeping an organization adequately staffed and not primarily as a motivator. Enterprises usually make wages and salaries competitive within their industry and their geographic area to attract and hold people.

Third, money as a motivator tends to be dulled somewhat by the practice of making the salaries of the various managers in a company reasonably similar. In other words, organizations often take great care to ensure that people on comparable levels are given the same, or nearly the same, compensation. This is understandable, since people usually evaluate their compensation in light of what their equals are receiving.

Fourth, if money is to be an effective motivator, people in various positions, even though at a similar level, must be given salaries and bonuses that reflect their individual performance. Even if a company is committed to the practice of comparable wages and salaries, a well-managed firm need never be bound to the same practice with respect to bonuses. In fact, it appears that, unless bonuses for managers are based to a major extent on individual performance, an enterprise is not buying much motivation with them. The way to ensure that money has meaning, as a reward for accomplishment and as a means of giving people pleasure from accomplishment, is to base compensation as much as possible on performance.

It is almost certainly true that money can motivate only when the prospective payment is large relative to a person's income. The trouble with many wage and salary increases, and even bonus payments, is that they are not large enough to motivate the receiver. They may keep the individual from being dissatisfied and from looking for another job, but they are not likely to be a strong motivator, unless they are large enough to be felt.

Traditionally, pay and promotion in Japan are based on seniority. However, in some Japanese companies, merit pay has been introduced. The reason is that some young Japanese professionals are leaving secure positions for exciting work in Internet companies. In order to keep employees, companies use merit pay based on performance.

**LEADERSHIP PERSPECTIVE**

## Executive Pay for Performance[21]

During the global financial meltdown in 2008-2009, many executives of companies with very poor performance received big pay packages. This created a public outcry. Compensation committees have to decide on the paychecks of business leaders.

Richard R. Floersch, the executive vice president of McDonald's Corporation and chairman of the Center on Executive Compensation argues that compensation should be an integral part of the company's strategy. While compensation has been used as a tool for recruitment and retention, other things should be considered. Compensation, for example, communicates the company's values and culture and its relationship with its workforce. Pay should go up with good performance and down with poor company results.

In determining executive pay, questions should be raised such as: Is both performance and sustainability considered? Short-term results could result in negative long-term performance. It has also been argued that the executives should own considerable amount of stocks to be held over a long period. This may discourage making decisions that could result in short-term performance (and increased pay) at the expense of long-term company sustainability. Many of the Fortune 100 companies have a "clawback – or recoup – policy" which goes into effect in the company that does not perform as expected. Thus, a pay-for-performance policy should also take the long-term effect on the company of executives' decisions. Leaders need to lead and share the benefits as well as the pain with the workforce in good as well as bad times.

## Other Rewards Considerations

**Intrinsic rewards** may include a feeling of accomplishment and self-actualization.

**Extrinsic rewards** include benefits, recognition, status symbols, and money.

Pay may be based on individual, group, and organizational performance.

Implicit in most motivation theories are intrinsic and extrinsic rewards. *Intrinsic rewards* may include a feeling of accomplishment, or even self-actualization. *Extrinsic rewards* include benefits, recognition, status symbols, and of course money. Some compensation plans may not provide a strong incentive, such as the hourly, weekly, or even annual salary. On the other hand, *incentive plans* may be based on piecework, sales commission, merit pay, bonus plans, profit or gain (e.g., productivity gain) sharing, and stock options. In Chapter 12 on performance appraisal, we illustrated the incentive plan at the Lincoln Electric Company. Some companies offer "cafeteria" compensation plans tailored to the needs and preferences of the individual employee.

The pay may be based on individual, group, and organizational performance. When the pay is based solely on *individual performance*, people may compete against each other, which may make teamwork and cooperation difficult. On the other hand, if *group performance* is the sole criterion for merit pay, some individuals may not contribute their fair share of effort. Considering *organizational performance* as a criterion of bonuses is based on the notion that employees contributed to outstanding performance and therefore should be rewarded. To realize the benefits of individual, group, and organizational reward systems, some companies use a combination of plans.

## Participation

There is increased awareness and use of a technique that has been given strong support by motivation theory and research, and that is participation. Only rarely are people not motivated by being consulted on action affecting them—by being "in on the act." In addition, most people at the center of an operation have knowledge both of problems and of solutions to them. As a consequence, the right kind of participation yields both motivation and knowledge valuable for enterprise success.

Participation is also a means of recognition. It appeals to the need for affiliation and acceptance. Above all, it gives people a sense of accomplishment. Encouraging participation, however, should not mean that managers weaken their position. Although they encourage participation of subordinates on matters with which the latter can help, and although they listen carefully, they must themselves decide on matters requiring *their* decision.



## Quality of Working Life

www.qwl.com

One of the most interesting approaches to motivation is the Quality of Working Life (QWL) program, which is a systems approach to job design and a promising development in the broad area of job enrichment, combined with a grounding in the sociotechnical systems approach to management (see Chapter 1). QWL is not only a very broad approach to job enrichment but also an interdisciplinary field of inquiry and action combining industrial and organizational psychology and sociology, industrial engineering, organization theory and development, motivational and leadership theory, and industrial relations. Although QWL rose to prominence only in the

1970s, there are now hundreds of case studies and practical programs and a number of QWL centers, primarily in the United States, Great Britain, and Scandinavia.

QWL has received enthusiastic support from a number of sources. Managers have regarded it as a promising means of dealing with stagnating productivity, especially in the United States and Europe. Workers and union representatives have also seen it as a means of improving working conditions and productivity and as a means of justifying higher pay. Government agencies have been attracted to QWL as a means of increasing productivity and reducing inflation and as a way of obtaining industrial democracy and minimizing labor disputes.

**INTERNATIONAL PERSPECTIVE**

### QWL in Action

In the development of a QWL program, certain steps are normally undertaken. Usually, a labor-management steering committee is set up, ordinarily with a QWL specialist or staff, which is charged with finding ways of enhancing the dignity, attractiveness, and productivity of jobs through job enrichment and redesign. The participation of workers and their unions (if an operation is unionized) in the effort is thought to be very important, not only because of the exercise of industrial democracy but also because of the great practical advantage it offers: people on a job are the ones who are best able to identify what would enrich the job for them and make it possible for them to be more productive. This typical QWL technique tends to solve the problem encountered in many job enrichment programs in which workers are not asked what would make the job more interesting for them.

Out of the deliberations of this committee, a number of changes may be suggested in the design of jobs and in the entire working environment. The recommendations of the committee may extend to such matters as reorganization of the enterprise, means of improving communication, problems that may never have surfaced before and their solutions, changes in work arrangements through technical modifications such as the redesign of an assembly line, better quality control, and other things that might improve organizational health and productivity.

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It is no wonder that QWL, with such possible important yields, has been spreading fast, especially in larger companies. Nor is it a surprise that leaders in adopting QWL programs should be such well-managed companies as General Motors, Proctor & Gamble, American Aluminum (ALCOA), and AT&T.

## JOB ENRICHMENT

Research and analysis of motivation point to the importance of making jobs challenging and meaningful. This applies to the jobs of managers as well as to those of nonmanagers. Job enrichment is related to Herzberg's theory of motivation, in which factors such as challenge, achievement, recognition, and responsibility are seen as

the real motivators. Even though his theory has not gone unchallenged, it has led to widespread interest worldwide in developing ways to enrich job content, particularly for nonmanagerial employees.

**Job enlargement** Enlarging the scope of the job by adding similar tasks without enhancing responsibility.

**Job enrichment** Building into jobs a higher sense of challenge and achievement.

Job enrichment should be distinguished from job enlargement (but some authors do not make this distinction). **Job enlargement** attempts to make a job more varied by removing the dullness associated with performing repetitive operations. It means enlarging the scope of the job by adding similar tasks without enhancing responsibility. For example, a production line worker may install not only the bumper on a car but also the front hood. Critics would say that this is simply adding one dull job to another, since it does not increase the worker's responsibility. In **job enrichment**, the attempt is to build into jobs a higher sense of challenge and achievement. Jobs may be enriched by variety. But they also may be enriched by (1) giving workers more freedom in deciding about such things as work methods, sequence, and pace or the acceptance or rejection of materials; (2) encouraging participation of subordinates and interaction between workers; (3) giving workers a feeling of personal responsibility for their tasks; (4) taking steps to make sure that workers can see how their tasks contribute to a finished product and to the welfare of the enterprise; (5) giving people feedback on their job performance, preferably before their supervisors get it; and (6) involving workers in the analysis and change of physical aspects of the work environment, such as the layout of the office or plant, temperature, lighting, and cleanliness.

## Limitations of Job Enrichment

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Even the strongest supporters of job enrichment readily admit that there are limitations in its application. One of these is technology. With specialized machinery and assembly line techniques, it may not be possible to make all jobs very meaningful. Another limitation is costs. General Motors tried six-person and three-person teams in the assembly of motor homes but found that this approach was too difficult, slow, and costly. On the other hand, two Swedish auto manufacturers, Saab and Volvo, have used the team approach and have found costs to be only slightly higher, and they believe that this increase is more than offset by reduction in absenteeism and turnover.

There is also some question as to whether workers really want job enrichment, especially of the kind that changes the basic content of their jobs. Various surveys of worker attitudes, even the attitudes of assembly line workers, have shown that a high percentage of workers are not dissatisfied with their jobs and that few want "more interesting" jobs. What these workers seem to want above all is job security and pay. Moreover, workers are concerned that changing the nature of tasks to increase productivity may mean a loss of jobs.

The limitations of job enrichment apply mainly to low-skill jobs. The jobs of highly skilled workers, professionals, and managers already contain varying degrees of challenge and accomplishment. Perhaps they could still be enriched considerably more than they are. But this can probably be done best by management techniques such as managing by objectives, utilizing more policy guidance with delegation of authority, introducing more status symbols in the form of titles and office facilities, and tying bonus and other rewards more closely to performance.

### Making Job Enrichment Effective

Several approaches can be used to make job enrichment appeal to higher-level motivations. First, organizations need a better understanding of what people want. As a number of motivation researchers have pointed out, wants vary with people and situations. Research has shown that workers with few skills want such factors as job security, pay, benefits, less restrictive rules, and more sympathetic and understanding supervisors. As people move up the ladder in an enterprise, they find that other factors become increasingly important. But little job enrichment research has been done on high-level professionals and managers.

Second, if productivity improvement is the main goal of enrichment, the program must show how workers will benefit. In one company with fleets of unsupervised two-person service trucks, a program of giving these employees 25 percent of the cost savings from increased productivity, while still making it clear that the company would profit from their efforts, resulted in a startling rise in output and a much greater interest in these jobs.

Third, people like to be involved, to be consulted, and to be given an opportunity to offer suggestions. They like to be considered as people. In one aerospace missile plant, increased morale and productivity, as well as greatly reduced turnover and absenteeism, resulted from the simple technique of having all employees' names on placards at their workstations and having each program group—from parts production and assembly to inspection—work in an area in which machines and equipment were painted a different color for each group.

Fourth, people like to feel that their managers are truly concerned with their welfare. Workers like to know what they are doing and why. They like feedback on their performance. They like to be appreciated and recognized for their work.

## A SYSTEMS AND CONTINGENCY APPROACH TO MOTIVATION

Motivation must be considered from a systems and contingency point of view

The foregoing analysis of theory, research, and application demonstrates that motivation must be considered from a systems and contingency point of view. Given the complexity of motivating people with individual personalities and in different situations, the risk of failure exists when any single motivator, or group of motivators, is applied without taking into account these variables. Human behavior is not a simple matter but must be looked upon as a complex system of variables and interactions of which certain motivating factors are an important element.

## SUMMARY

Leading is the process of influencing people so that they will contribute to organizational and group goals. People assume different roles, and there is no average person. While working toward goals, a manager must take into account the dignity of the whole person.

Motivation is not a simple concept; rather, it pertains to various drives, desires, needs, wishes, and other forces. Managers motivate by providing an environment that induces organization members to contribute.

There are different views and assumptions about human nature. McGregor called his sets of assumptions about people Theory X and Theory Y. Maslow's theory holds that human needs form a hierarchy ranging from the lowest-order needs (physiological needs) to the highest-order need (the need for self-actualization). Alderfer's ERG theory, which has only three categories (Maslow has five), suggests that a person may be motivated in more than one category at the same time. According to Herzberg's two-factor theory, there are two sets of motivating factors. In one set are the dissatisfiers, which are related to the job context (circumstances, conditions). The absence of these factors results in dissatisfaction. In the other set are the satisfiers, or motivators, which are related to the content of the job.

Vroom's expectancy theory of motivation suggests that people are motivated to reach a goal if they think that the goal is worthwhile and they can see that their activities will help them achieve the goal. The Porter and Lawler model has many variables. Essentially, performance is a function of ability, the perception of the task required, and effort. Effort is influenced by the value of rewards and the perceived effort–reward probability. Performance accomplishment, in turn, is related to rewards and satisfaction.

Equity theory refers to an individual's subjective judgment about the fairness of the reward received for inputs in comparison with the rewards of others. Skinner's reinforcement theory suggests that people are motivated by praise for desirable behavior; people should participate in setting their goals and should receive regular feedback with recognition and praise. Goals can motivate if they are attainable, verifiable, and understood and accepted by the people who have to achieve them. McClelland's theory is based on the need for power, the need for affiliation, and the need for achievement.

Special motivational techniques include using money and other rewards considerations, encouraging participation, and improving the quality of working life. Job enrichment aims at making jobs challenging and meaningful. Although there have been some successes at job enrichment, certain limitations must not be overlooked.

The complexity of motivation requires a contingency approach that takes into account environmental factors.

## KEY IDEAS AND CONCEPTS FOR REVIEW

- ✔ Leading
- ✔ Human factors in managing
- ✔ Individual dignity
- ✔ Motivation
- ✔ McGregor's Theory X and Theory Y
- ✔ Maslow's needs hierarchy
- ✔ Alderfer's ERG theory
- ✔ Herzberg's motivation-hygiene theory
- ✔ Vroom's expectancy theory
- ✔ Porter and Lawler's motivation model
- ✔ Equity theory
- ✔ Goal setting theory of motivation
- ✔ Positive reinforcement or behavior modification
- ✔ McClelland's needs theory

- ✔ Money and other rewards considerations
- ✔ Quality of Working Life
- ✔ Job enrichment
- ✔ Systems and contingency approach to motivation

## FOR DISCUSSION

1. What is motivation? How does effective managing take advantage of, and contribute to, motivation?
2. What are Theory X and Theory Y assumptions? State your reasons for agreeing or disagreeing with these assumptions. What are some misunderstandings of these theories?
3. Why has the Maslow theory of needs been criticized? To what extent is it valid?
4. Compare and contrast the Maslow and Herzberg theories of motivation. On what grounds has the Herzberg theory been criticized? Why would you suspect that Herzberg's approach has been very popular with practicing managers?
5. Explain Vroom's expectancy theory of motivation. How is it different from the Porter and Lawler approach? Which appeals to you as being more accurate? Which is more useful in practice?
6. Explain McClelland's theory of motivation. How does it fit into a systems approach?
7. "You cannot motivate managers. They are self-propelled. You just get out of their way if you really want performance." Comment.
8. To what extent, and how, is money an effective motivator?
9. What motivates you in striving toward excellence in your work at school? Are these motivating forces shown in any of the models discussed in this chapter?

## EXERCISES/ACTION STEPS

1. The instructor may take a survey in class and ask students to respond to two questions: (1) "Can you describe in detail when you felt exceptionally good about your job?" and (2) "Can you describe in detail when you felt exceptionally bad about your job?" Students should write their answers on a sheet of paper. Then each individual should be encouraged to share his or her good and bad work experiences with the class. The instructor can classify these responses according to Herzberg's two-factor theory and point out the weakness in this research design.
2. Collect information on an organization that you know and identify the reasons why people contribute to the goals of the enterprise.

## INTERNET RESEARCH

1. Surf the Internet for the term "motivation." You will get many "hits." Select one for class discussion.
2. Use a popular search engine and type the first and last name of any authors discussed in this chapter. Do you find information that goes beyond what has been discussed in this chapter? If so, what is it?

## International Case — Managing the Hewlett-Packard Way: Will It Continue?[22]

William R. Hewlett and David Packard are two organizational leaders who demonstrated a unique managerial style. They began their operation in a one-car garage in 1939 with $538 and eventually built a very successful company that now produces more than 10,000 products, such as computers, peripheral equipment, test and measuring instruments, and handheld calculators. Perhaps even better known than its products is the distinct managerial style preached and practiced at Hewlett-Packard (HP). It is known as the HP Way.

What is the HP Way? I feel that in general terms it is the policies and actions that flow from the belief that men and women want to do a good job, a creative job, and that if they are provided the proper environment they will do so.

**Bill Hewlett, HP co-founder[23]**

The values of the founders, who withdrew from active management in 1978, still permeate the organization. The HP way emphasizes honesty, a strong belief in the value of people, and customer satisfaction. The managerial style also emphasizes an open-door policy, which promotes team effort. Informality in personal relationships is illustrated by the use of first names. Management by objectives is supplemented by what is known as managing by wandering around. By strolling through the organization, top managers keep in touch with what is really going on in the company.

This informal organizational climate does not mean that the organization structure has not changed. Indeed, the organizational changes in the 1980s in response to environmental forces were quite painful. However, these changes resulted in extraordinary company growth in that decade.

In the 21st century, however, the fortune began to change. In the new competitive environment, HP felt it necessary to merge with another computer giant, Compaq. The merger architect, Carly Fiorina, was strongly opposed by Walter Hewlett, the son of William Hewlett. After a close vote, the merger was approved, but not without a challenge by Mr. Hewlett. Still, the merger, which was opposed by the majority of HP's employees, went through. Now the challenge begins for Ms. Fiorina not only to reestablish the morale of the HP people but also to merge the HP culture with that of Compaq. Critics predict the HP way cannot be continued.[24]

**Questions**

1. Is the HP way of managing creating a climate in which employees are motivated to contribute to the aims of the organization? What is unique about the HP way?
2. Would the HP managerial style work in any organization? Why or why not? What are the conditions for such a style to work?
3. Do you think it is possible to maintain the HP way after the merger with Compaq, the court battle, and the damaged morale at HP? Why or why not?



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# 15 Leadership

## Chapter Objectives

After studying this chapter, you should be able to:

- Define leadership and its ingredients
- Describe the trait approaches and charismatic leadership approach and their limitations
- Discuss various leadership styles based on the use of authority
- Identify the two dimensions of the managerial grid and the resulting extreme leadership styles
- Recognize that leadership can be seen as a continuum
- Explain the contingency approach to leadership
- Describe the path–goal approach to leadership effectiveness
- Distinguish between transactional and transformational leaders

Although some people treat the terms *managership* and *leadership* as synonyms, the two should be distinguished. As a matter of fact, there can be leaders of completely unorganized groups, but there can be managers, as conceived here, only where organized structures create roles. Separating leadership from managership has important analytical advantages. It permits leadership to be singled out for study without the encumbrance of qualifications relating to the more general issue of managership.

Leadership is an important aspect of managing. As this chapter will show, the ability to lead effectively is one of the keys to being an effective manager; also, undertaking the other essentials of managing—doing the entire managerial job—has an important bearing on ensuring that a manager will be an effective leader. Managers must exercise all the functions of their role in order to combine human and material resources to achieve objectives. The key to doing this is the existence of a clear role and a degree of discretion or authority to support managers' actions.

The essence of leadership is followership. In other words, it is the willingness of people to follow that makes a person a leader. Moreover, people tend to follow those whom they see as providing a means of achieving their own desires, wants, and needs.

Leadership and motivation are closely interconnected.

Leadership and motivation are closely interconnected. By understanding motivation, one can appreciate better what people want and why they act as they do.

Leaders may not only respond to subordinates' motivations but also arouse or dampen them by means of the organizational climate they develop. Both these factors are as important to leadership as they are to managership.

## DEFINING LEADERSHIP[1]

**Leadership** The art or process of influencing people so that they will strive willingly and enthusiastically toward the achievement of group goals.

Leadership has different meanings to different authors.[2] Harry Truman, former American President, said that leadership is the ability to get men (women) to do what they don't like and like it. In this book, **leadership** is defined as influence, that is, the art or process of influencing people so that they will strive willingly and enthusiastically toward the achievement of group goals.[3] Ideally, people should be encouraged to develop not only willingness to work but also willingness to work with zeal and confidence. Zeal is ardor, earnestness, and intensity in the execution of work; confidence reflects experience and technical ability. Leaders act to help a group attain objectives through the maximum application of its capabilities. They do not stand behind a group to push and prod; they place themselves before the group as they facilitate progress and inspire the group to accomplish organizational goals. A good example is an orchestra leader, whose function is to produce coordinated sound and correct tempo through the integrated effort of the musicians. The performance of the orchestra will depend on the quality of the director's leadership.

**LEADERSHIP PERSPECTIVE**

### Jim Sinegal, Costco's CEO— A Leader with Heart or Smart?[4]

Costco's warehouse club is one of the most successful U.S. retailers of its kind led by its CEO Jim Sinegal. While many CEOs insist on fancy offices and other perks, not so Sinegal (who likes to be called "Jim"), who has a simple office with two folding tables. His wardrobe is from his own warehouse rather than from fashion designers and he wears a name tag when visiting his stores. In his interview with *Wall Street Journal*, he discussed his plan of opening about 30 new stores in the U.S. in 2007. He also considers opportunities in China and India, but India's laws, at this time, would restrict use of his business model. Costco already operates in Mexico and Japan.

Competing with Wal-Mart, that wants to be known for its low prices, Costco pays better salaries than Wal-Mart and most of Costco's rivals. Sinegal said in an interview: "If you hire good people, pay them good wages and provide good jobs and careers, good things will happen in your business. We think that's proven true in our case. We are the low-cost provider of merchandise, and yet we pay the highest wages." It may be smart to lead with the heart.

## INGREDIENTS OF LEADERSHIP[5]

www.chrysler.com

www.ge.com

www.microsoft.com

**Ingredients of leadership:** Power; a fundamental understanding of people; the ability to inspire followers to apply their full capabilities; the leader's style and the development of a conducive organizational climate.

Leaders envision the future; they inspire organization members and chart the course of the organization. Former CEOs Lee Iacocca at Chrysler and Jack Welch at General Electric as well as Bill Gates at Microsoft have provided a vision for their companies. Leaders must instill values—whether they are concerned for quality, honesty, and calculated risk taking or concerned for employees and customers.

Every group of people that performs near its total capacity has some person as its head who is skilled in the art of leadership. This skill seems to be a compound of at least four major ingredients: (1) the ability to use power effectively and in a responsible manner, (2) the ability to comprehend that human beings have different motivating forces at different times and in different situations, (3) the ability to inspire, and (4) the ability to act in a manner that will develop a climate conducive to responding to and arousing motivations.

The first ingredient of leadership is power. The nature of power and the difference between power and authority were discussed in Chapter 9. The second ingredient of leadership is a fundamental understanding of people. As in all other practices, it is one thing to know motivation theory, kinds of motivating forces, and the nature of a system of motivation but another thing to be able to apply this knowledge to people and situations. A manager or any other leader who at least knows the present state of motivation theory and who understands the elements of motivation is more aware of the nature and strength of human needs and is better able to define and design ways of satisfying them and to administer so as to get the desired responses.

The third ingredient of leadership is the rare ability to inspire followers to apply their full capabilities to a project. While the use of motivators seems to center on subordinates and their needs, inspiration comes from group heads, who may have qualities of charm and appeal that give rise to loyalty, devotion, and a strong desire on the part of followers to promote what leaders want. This is not a matter of needs satisfaction; it is, rather, a matter of people giving unselfish support to a chosen champion. The best examples of inspirational leadership come from hopeless and frightening situations—an unprepared nation on the eve of battle, a prison camp with exceptional morale, or a defeated leader undeserted by faithful followers. Some may argue that such devotion is not entirely unselfish, that it is in the interests of those who face catastrophe to follow a person they trust. Few, however, would deny the value of personal appeal in either case.

The fourth ingredient of leadership has to do with the style of the leader and the organizational climate he or she develops. As the previous chapter has shown, the strength of motivation greatly depends on expectancies, perceived rewards, the amount of effort believed to be required, the task to be done, and other factors that are part of an environment, as well as on organizational climate. Awareness of these factors has led to considerable research on leadership behavior and to the development of various pertinent theories. The views of those who have long approached leadership as a psychological study of interpersonal relationships have tended to converge with the personal viewpoint expressed in this book—that the primary tasks of managers are the design and maintenance of an environment for performance.

John Gabarro and John Kotter added another ingredient: effective managers must develop a healthy relationship with their boss.[6] It means that this relationship is based on mutual dependence. Thus, the manager must understand the boss's goals and pressures and give attention to his or her concerns.

**Principle of leadership** Since people tend to follow those who offer them a means of satisfying their personal goals, the more managers understand what motivates their subordinates and the more they reflect this understanding in their actions, the more effective they are likely to be as leaders.

Almost every role in an organized enterprise is made more satisfying for participants and more productive for the enterprise by those who can help others fulfill their desire for such things as money, status, power, and pride of accomplishment. The fundamental **principle of leadership** is this: since people tend to follow those who, in their view, offer them a means of satisfying their personal goals, the more managers understand what motivates their subordinates and how these motivators operate, and the more they reflect this understanding in carrying out their managerial actions, the more effective they are likely to be as leaders.

Because of the importance of leadership in all kinds of group action, there is a considerable volume of theory and research concerning it. It is difficult to summarize such a large body of research in a form relevant to day-to-day management. However, examined ahead are several major types of leadership theory and research, together with outlines of some basic kinds of leadership styles.

LEADERSHIP PERSPECTIVE

### Canon's Fumio Mitarai: Not the Typical Japanese CEO

www.canon.com

By Japanese standards, Fumio Mitarai is a contrarian. He is not so much a consensus builder, but rather takes decisive actions by himself, such as discontinuing Canon's personal computer division. Moreover, rather than focusing on enlarging market share (as has been typical of Japanese companies in the United States), Mitarai focuses on profits. This profit orientation may have been influenced by his experience in America. He has been stated as saying, "I had different business standards and found Japan too irrational."[7] At any rate, he increased his global digital market share from 9 percent in 2000 to 14 percent in 2001. Will other Japanese managers follow his example?

## TRAIT APPROACHES TO LEADERSHIP[8]

Prior to 1949, studies of leadership were based largely on an attempt to identify the traits that leaders possess. Starting with the "great man" theory that leaders are born and not made, a belief dating back to the ancient Greeks and Romans, researchers have tried to identify the physical, mental, and personality traits of various leaders. That theory lost much of its acceptability with the rise of the behaviorist school of psychology.

Many studies of traits have been made. Ralph M. Stogdill found that various researchers had identified specific traits related to leadership ability: five physical traits (such as energy, appearance, and height), four intelligence and ability traits, 16 personality traits (such as adaptability, aggressiveness, enthusiasm, and self-

confidence), six task-related characteristics (such as achievement drive, persistence, and initiative), and nine social characteristics (such as cooperativeness, interpersonal skills, and administrative ability).[9]

The discussion of the importance of traits to leadership goes on. More recently, the following key leadership traits have been identified: drive (including achievement, motivation, energy, ambition, initiative, and tenacity), leadership motivation (the aspiration to lead but not to seek power as such), honesty and integrity, self-confidence (including emotional stability), cognitive ability, and an understanding of the business. Less clear is the impact of creativity, flexibility, and charisma on leadership effectiveness.

In general, the study of leaders' traits has not been a very fruitful approach to explaining leadership. Not all leaders possess all the traits, and many nonleaders may possess most or all of them. Also, the trait approach gives no guidance as to *how much* of any trait a person should have. Furthermore, the dozens of studies that have been made do not agree as to which traits are leadership traits or what their relationships are to actual instances of leadership. Most of these so-called traits are really patterns of behavior.

## CHARISMATIC LEADERSHIP APPROACH

Charismatic leadership is closely related to the above discussion. One of the early studies of charismatic characteristics was done by Robert J. House.[10] He and other authors indicate that charismatic leaders may have certain characteristics, such as being self-confident, having strong convictions, articulating a vision, being able to initiate change, communicating high expectations, having a need to influence followers and supporting them, demonstrating enthusiasm and excitement, and being in touch with reality.[11] While these may be admirable characteristics, as we will note later in this chapter, other factors such as the characteristics of the followers and the situation may impact on effective leadership.

**LEADERSHIP PERSPECTIVE**

### Meet Wipro's Azim Premji, India's Leading High-Tech Architect[12]

www.wipro.com

When Mr. Premji was studying as an engineering student at Stanford University during the 1960s, he received note from India to return to his home country to take care of the family's peanut oil business. The Western India Vegetable Products Limited became Wipro, a $ 3 billion leading information technology, business process operations firm, and research and development services company. Among the four broad range software companies in India, Wipro focuses on technology systems.

Premji is one of the richest persons in India who built a company based on leadership values. He thinks that ordinary people are able to do extraordinary things. He is very interested in developing teams and leaders and participates in teaching

in Wipro's leadership development programs. He is recognized for his efforts in Lean management (discussed in Chapter 20 in this book) and was the first Indian company applying the Six Sigma approach (that is a quality level of not more that 3.4 defects for a million operations) to quality management. His societal vision is a quality primary education for every child.

The highly respected Indian Institute of Technology in India, among other institutions, conferred on him an honorary doctoral degree. Despite his fame and wealth, he is very moderate in the selection of cars he drives, starting with the Ford Escort (made in India) and later the rather inexpensive Toyota Corolla.

Azim Premji through his leadership transformed the peanut oil firm to one of the most respected Indian technology services companies.

## LEADERSHIP BEHAVIOR AND STYLES

There are several theories on leadership behavior and styles. This section focuses on (1) leadership based on the use of authority, (2) the managerial grid, and (3) leadership involving a variety of styles, ranging from a maximum to a minimum use of power and influence.

### Styles Based on Use of Authority

The **autocratic leader** commands and expects compliance, is dogmatic and positive, and leads by the ability to withhold or give rewards and punishment.

The **democratic, or participative, leader** consults with subordinates and encourages their participation.

The **free-rein leader** uses power very little, if at all, giving subordinates a high degree of independence.

Some earlier explanations of leadership styles classified the styles on the basis of how leaders use their authority. Leaders are seen as applying three basic styles. The **autocratic leader** commands and expects compliance, is dogmatic and positive, and leads by the ability to withhold or give rewards and punishment. The **democratic, or participative, leader** consults with subordinates on proposed actions and decisions and encourages participation from them. This type of leader ranges from the person who does not take action without subordinates' concurrence to the one who makes decisions but consults with subordinates before doing so.

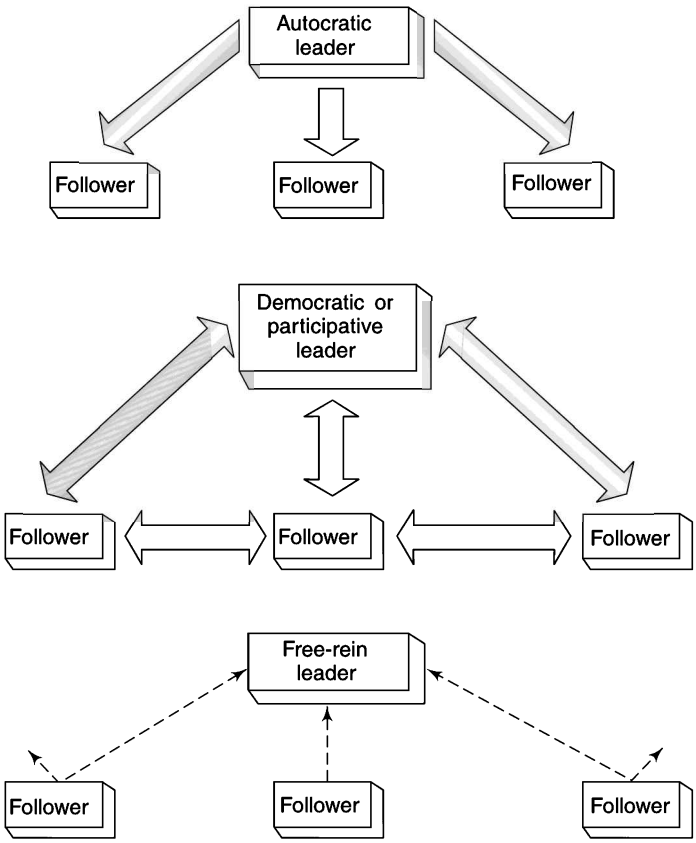
The **free-rein leader** uses his or her power very little, if at all, giving subordinates a high degree of independence in their operations. Such leaders depend largely on subordinates to set their own goals and the means of achieving them, and they see their role as one of aiding the operations of followers by furnishing them with information and acting primarily as a contact with the group's external environment. Figure 15.1 illustrates the flow of influence in the three leadership situations.

There are variations within this simple classification of leadership styles. Some autocratic leaders are seen as "benevolent autocrats". Although they listen considerately to their followers' opinions before making a decision, the decision is their own. They may be willing to hear and consider subordinates' ideas and concerns; but when a decision is to be made, they may be more autocratic than benevolent.

A variation of the participative leader is the person who is supportive. Leaders in this category may look upon their task as not only consulting with followers and carefully considering their opinions but also doing all they can to support subordinates in accomplishing their duties.

**Figure 15.1**

**The Flow of Influence with Three Leadership Styles.**




The use of any style will depend on the situation. A manager may be highly autocratic in an emergency; one can hardly imagine a fire chief holding a long meeting with the crew to consider the best way of fighting a fire. Managers may also be autocratic when they alone have the answers to certain questions.

A leader may gain considerable knowledge and a better commitment from the people involved by consulting with them. As already noted, this is true in developing verifiable objectives under systems of managing by objectives. Furthermore, a manager dealing with a group of research scientists may give them free rein in developing their inquiries and experiments. But the same manager might be quite autocratic in enforcing a rule stipulating that employees wear a protective covering when they are handling potentially dangerous chemicals.

## Do Women Lead Differently?

Women as managers may use a different leadership style than men. One study

found that women see leadership as changing the self-interest of followers into concern for the total enterprise by using interpersonal skills and personal traits to motivate subordinates.[13] This *interactive leadership* style involves sharing information and power, inspiring participation, and letting people know that they are important. Men, in contrast, are more likely to see leadership as a sequence of transactions with their subordinates. Moreover, they more often use control of resources and the authority of their position to motivate their people. This does not mean that all successful women and men use the respective leadership styles. Certainly, some men use interactive leadership in guiding their subordinates, and some women use the traditional command structure in directing their followers.

**LEADERSHIP PERSPECTIVE**

### Anita Roddick Leading the Body Shop International[14]

www.bodyshop.com

The Body Shop International is an environmentally conscious and socially responsive cosmetic company with more than 1,600 shops located around the world. It was founded in England in 1976 by Anita Roddick. Originally, she developed the products herself in her kitchen. Her unique philosophy and business practices were unconventional in the cosmetic industry, emphasizing the use of natural ingredients and packaging products in reusable containers. The company avoided animal testing of their products and also identified the ingredients used. Employees were selected on the basis of their idealistic motivations and their social and environmental consciousness. The Body Shop's methods of marketing and sales were in sharp contrast to the large cosmetic companies' using fashion models and glitzy advertising.

The Body Shop was originally very successful but encountered difficulties in the 1990s. Although the number of stores grew, the turnovers in the stores were flat. In 1998, Anita Roddick resigned as CEO. Some observers were wondering whether customers equally shared her social consciousness. They were also curious why people would be attracted to a company that used very little advertising, if any at all. Moreover, would the company be able to maintain Ms. Roddick's philosophy and business practices after she vacated her CEO position?



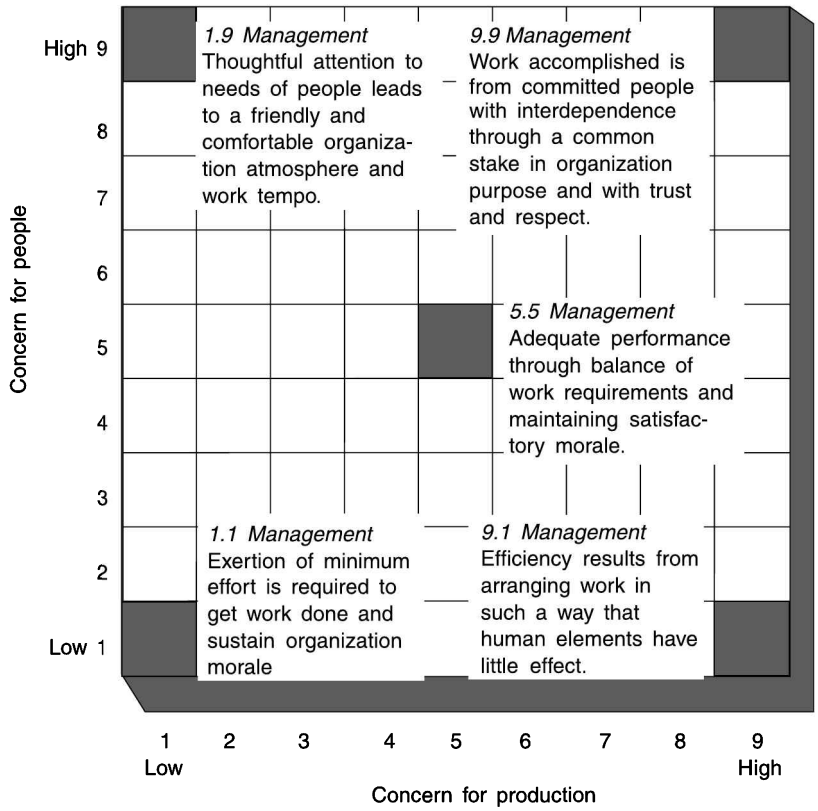
## The Managerial Grid

A well-known approach to defining leadership styles is the managerial grid, developed decades ago by Robert Blake and Jane Mouton.[15] Building on previous research that showed the importance of a manager's having concern both for production and for people, Blake and Mouton developed a clever device to dramatize this concern. This grid, shown in Figure 15.2, has been used throughout the world as a means of training managers and of identifying various combinations of leadership styles.

**Figure 15.1**

**The Managerial Grid.**

**Adapted from R. R. Blake and J. S. Mouton, *The Managerial Grid* (Houston, Texas: Gulf Publishing Company, 1964) p.10**




The **managerial grid** has two dimensions: concern for people and concern for production.

## The grid dimensions

The grid has two dimensions: concern for people and concern for production. As Blake and Mouton emphasize, their use of the phrase *concern for* is meant to convey *how* managers are concerned about production or *how* they are concerned about people and not such things as *how much* production they are concerned about getting out of a group.

Concern for production includes the attitude of a supervisor toward a wide variety of things, such as the quality of policy decisions, procedures and processes, creativeness of research, quality of service, work efficiency, and volume of output. Concern for people is likewise interpreted in a broad way. It includes such elements as the degree of personal commitment toward goal achievement, maintenance of the self-esteem of workers, placement of responsibility on the basis of trust rather than obedience, provision of good working conditions, and maintenance of satisfying interpersonal relations.

**The four extreme styles** Blake and Mouton recognize four extremes of style. Under the **1.1** style (referred to as impoverished management), managers concern themselves very little with either people or production and have minimum involvement in their jobs; to all intents and purposes, they have abandoned their jobs and only mark time or act as messengers communicating information from superiors to subordinates. At the other extreme are the **9.9** managers, who display in their actions the highest possible dedication both to people and to production. They are the real "team managers," who are able to mesh the production needs of the enterprise with the needs of individuals.

Another style is the **1.9** management (called country club management by some), in which managers have little or no concern for production but are concerned only for people. They promote an environment in which everyone is relaxed, friendly, and happy and no one is concerned about putting forth coordinated effort to accomplish enterprise goals. At another extreme are the **9.1** managers (sometimes referred to as autocratic task managers), who are concerned only with developing an efficient operation, who have little or no concern for people, and who are quite autocratic in their style of leadership.

By using these four extremes as points of reference, every managerial technique, approach, or style can be placed somewhere on the grid. Clearly, the **5.5** managers have medium concern for production and for people. They obtain adequate, but not outstanding, morale and production. They do not set goals too high and are likely to have a rather benevolently autocratic attitude toward people.

The managerial grid is a useful device for identifying and classifying managerial styles, but it does not tell us *why* a manager falls into one part or another of the grid. To determine the reason, one has to look at underlying causes, such as the personality characteristics of the leader or the followers, the ability and training of managers, the enterprise environment, and other situational factors that influence how leaders and followers act.

## Leadership as a Continuum

**Leadership continuum concept** Leadership involves a variety of styles, ranging from one that is highly boss-centered to one that is highly subordinate-centered.

The appropriate leadership style depends on the leader, the followers, and the situation.

The adaptation of leadership styles to different contingencies has been well characterized by Robert Tannenbaum and Warren H. Schmidt, developers of the **leadership continuum concept**. As Figure 15.3 shows, they see leadership as involving a variety of styles, ranging from one that is highly boss-centered to one that is highly subordinate-centered. The styles vary with the degree of freedom a leader or manager grants to subordinates. Thus, instead of suggesting a choice between the two styles of leadership—authoritarian or democratic—this approach offers a range of styles, with no suggestion that one is always right and another is always wrong.

The continuum theory recognizes that the appropriate style of leadership depends on the *leader*, the *followers*, and the *situation*. To Tannenbaum and Schmidt, the most important elements that may influence a manager's style can be seen along a continuum as (1) the forces operating in the manager's personality, including his or her value system, confidence in subordinates, inclination toward leadership styles, and feelings of security in uncertain situations; (2) the forces in subordinates (such as their willingness to assume responsibility, their knowledge and experience, and their

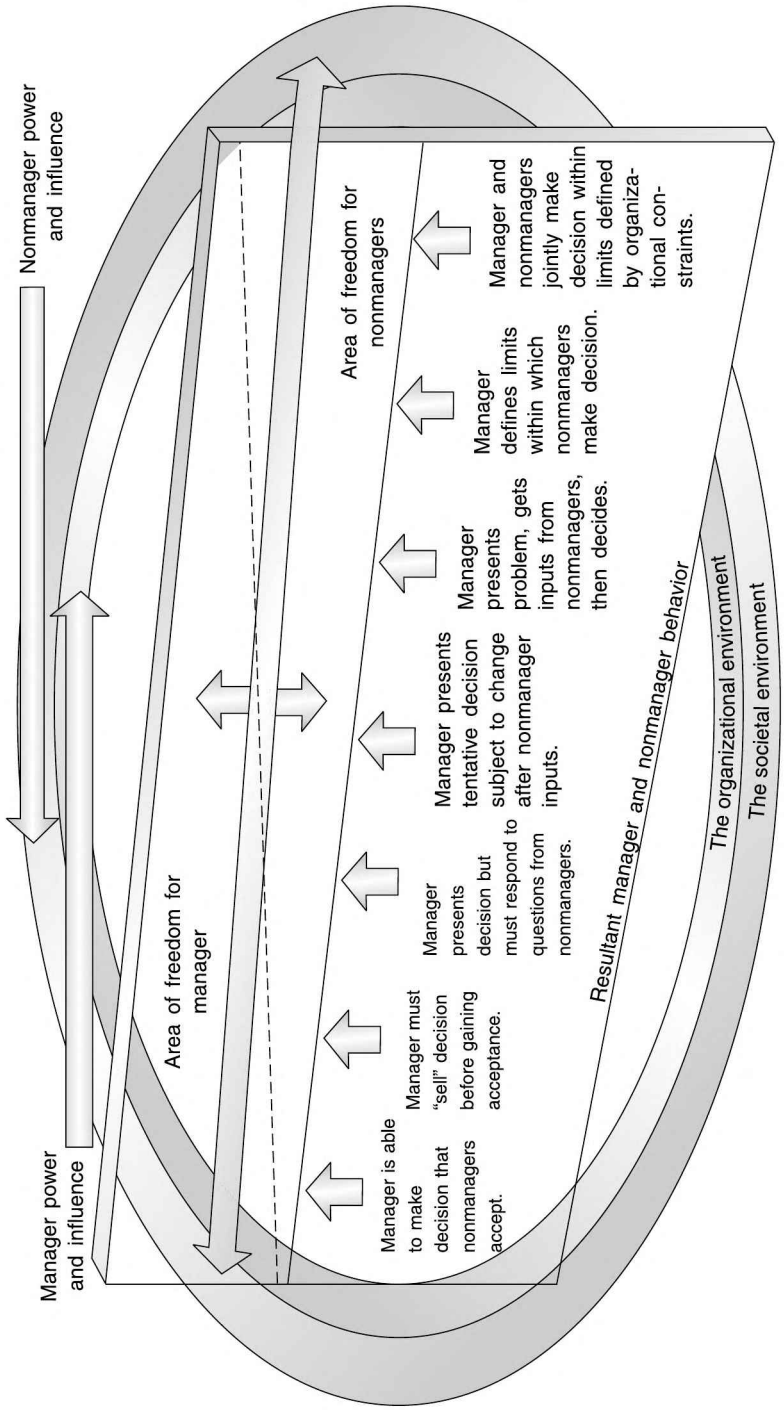



**Figure 15.3**
**Continuum of Manager-Nonmanager Behavior.**
**Used with permission from R. Tannenbaum and W. H. Schmidt, "Retrospective Commentary on How to Choose a Leadership Pattern," *Harvard Business Review*, vol. 51, no. 3 (May–June 1973), p 167.**

tolerance for ambiguity) that will affect the manager's behavior; and (3) the forces in the situation, such as organizational values and traditions, the effectiveness of subordinates working as a unit, the nature of a problem and the feasibility of safely delegating the authority to handle it, and the pressure of time.

In reviewing their continuum model in 1973 (it was first formulated in 1958), Tannenbaum and Schmidt placed circles around the model, as shown in Figure 15.3, to represent the influences on style imposed by both the organizational environment and the societal environment.[16] This was done to emphasize the open-system nature of leadership styles and the various impacts of the organizational environment and the social environment outside an enterprise. In their 1973 commentary, they put increased stress on the interdependency of leadership style and environmental forces—such as labor unions, greater pressures for social responsibility, the civil rights movement, and the ecology and consumer movements—that challenge the rights of managers to make decisions or handle their subordinates without considering interests outside the organization.

## SITUATIONAL OR CONTINGENCY APPROACHES TO LEADERSHIP

As disillusionment with the "great man" and trait approaches to understanding leadership increased, attention turned to the study of situations and the belief that leaders are the product of given situations. A large number of studies have been made on the premise that leadership is strongly affected by the situation from which the leader emerges and in which he or she operates. That this is a persuasive approach is indicated by the emergence of Franklin Delano Roosevelt in the Great Depression of the 1930s in the United States and the rise of Mao Zedong in China in the period after World War II. This approach to leadership recognizes that there exists an interaction between the group and the leader. It supports the follower theory that people tend to follow those whom they perceive (accurately or inaccurately) as offering them a means of accomplishing their personal desires. The leader, then, is the person who recognizes these desires and does things, or undertakes programs, designed to meet them.

**Contingency theory of leadership** People become leaders not only because of their personality attributes but also because of various situational factors and the interactions between leaders and group members.

Situational or contingency approaches obviously have much meaning for managerial theory and practice. They also tie into the system of motivation discussed in Chapter 14 and are important for practicing managers who must consider the situation when they design an environment for performance.

### Fiedler's Contingency Approach to Leadership

Although their approach to leadership theory is primarily one of analyzing leadership style, Fred E. Fiedler and his associates at the University of Illinois came up with a **contingency theory of leadership**.[17] The theory holds that people become leaders not only because of the attributes of their personalities but also because of various situational factors and the interactions between leaders and group members.

**Critical dimensions of the leadership situation** On the basis of his studies, Fiedler describes three critical dimensions of the leadership situation that help determine what style of leadership will be most effective:

1. *Position power*. This is the degree to which the power of a position, as distinguished from other sources of power, such as personality or expertise, enables a leader to get group members to comply with directions. In the case of managers, this is the power arising from organizational authority. As Fiedler points out, a leader with clear and considerable position power can obtain good followership more easily than one without such power.
2. *Task structure*. With this dimension, Fiedler has in mind the extent to which tasks can be clearly spelled out and people held responsible for them. If tasks are clear (rather than vague and unstructured), the quality of performance can be more easily controlled and group members can be held more definitely responsible for performance.
3. *Leader-member relations*. Fiedler regards this dimension as the most important from a leader's point of view, since position power and task structure may be largely under the control of an enterprise. It has to do with the extent to which group members like and trust a leader and are willing to follow that leader.

**Leadership styles** To approach his study, Fiedler set forth two major styles of leadership. One of these is primarily task-oriented, with the leader gaining satisfaction from seeing tasks performed. The other is oriented primarily toward achieving good interpersonal relations and attaining a position of personal prominence.

To measure leadership styles and determine whether a leader is chiefly task-oriented, Fiedler used an unusual testing technique. He based his findings on two types of sources: (1) scores on the *Least Preferred Coworker* (LPC) scale, which are ratings made by people in a group of members with whom they would least like to work; and (2) scores on the *Assumed Similarity between Opposites* (ASO) scale, which are ratings based on the degree to which leaders see group members as being like themselves, on the assumption that people will like best, and work best with, those who are seen as most like themselves. Today, the LPC scale is most commonly used in research. In developing this scale, Fiedler asked respondents to identify the traits of a person with whom they could work least well.[18] Respondents described the person by rating 16 items on a scale of attributes, such as the following:

| | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| Pleasant | \| | \| | \| | \| | \| | \| | \| | \| | Unpleasant |
| Rejecting | \| | \| | \| | \| | \| | \| | \| | \| | Accepting |

On the basis of his studies with this method, as well as studies done by others, Fiedler found that people who rated their coworkers high (i.e., in favorable terms) were those who derived major satisfaction from successful interpersonal relationships. People who rated their "least preferred coworker" low (i.e., in unfavorable terms) were seen as deriving their major satisfaction from task performance.

From his research, Fiedler came to some interesting conclusions. Recognizing that personal perceptions may be unclear and even quite inaccurate, he nonetheless found the following to be true:

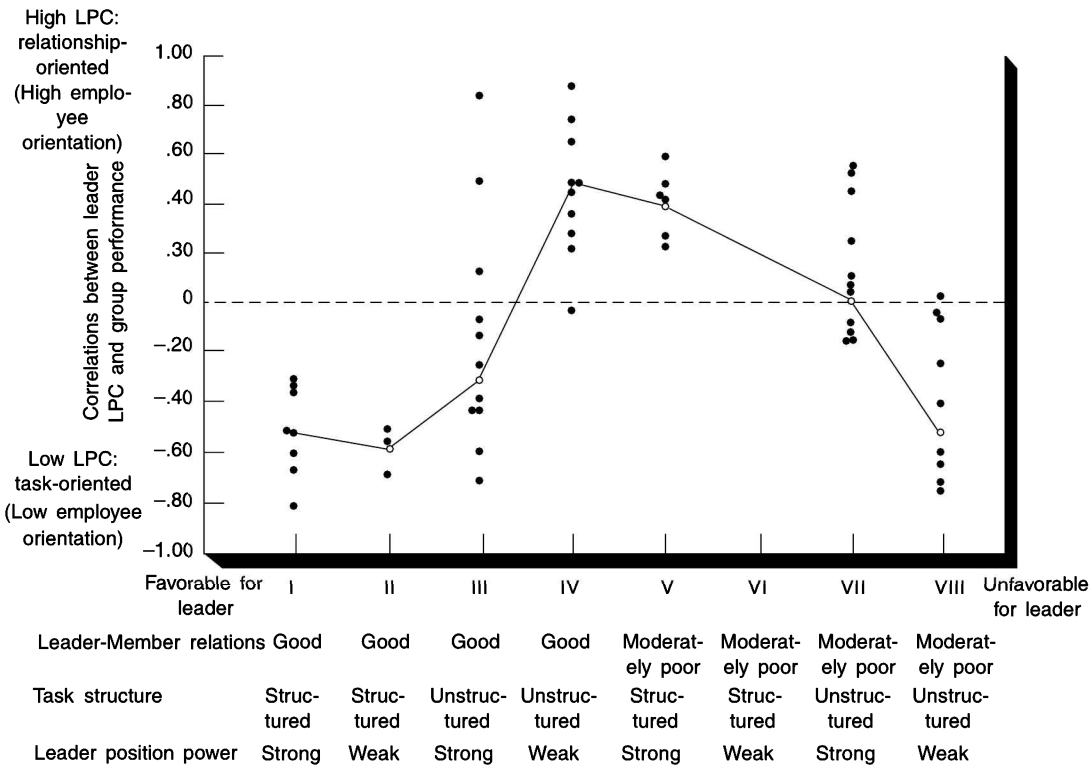
> Leadership performance depends as much on the organization as it depends on the leader's own attributes. Except perhaps for the unusual case, it is simply not meaningful to speak of an effective leader or an ineffective leader; we can only speak of a leader who tends to be effective in one situation and ineffective in another. If we wish to increase organizational and group effectiveness, we must learn not only how to train leaders more effectively but also how to build an organizational environment in which the leader can perform well.[19]

Fiedler's contingency model of leadership is presented as a graph in Figure 15.4. This figure is really a summary of Fiedler's research, in which he found that in "unfavorable" or "favorable" situations the task-oriented leader would be the most effective. **Favorableness of situation** is defined by Fiedler as the degree to which a given situation enables a leader to exert influence over a group. In other words, when leader position power is weak, the task structure is unclear, and leader–member relations are moderately poor, the situation is unfavorable for the leader and the

**Figure 15.1**

**Fiedler's Model of Leadership.**

**Each dot in the graph represents findings from a research study.**
**Adapted from F. E. Fiedler, *A Theory of Leadership Effectiveness* (New York: McGraw-Hill, 1967), p. 146. Used with permission.**



most effective leader will be one who is task-oriented (see the lower right corner of the graph). At the other extreme, where position power is strong, the task structure is clear, and leader–member relations are good—a favorable situation for the leader—the task-oriented leader will also be most effective. However, if the situation is only moderately unfavorable or favorable (the middle of the horizontal scale in the figure), the relationship-oriented leader will be most effective.

In a highly structured situation, such as in the military during a war, where the leader has strong position power and good relations with members, there is a favorable situation in which task orientation is the most appropriate. The other extreme, an unfavorable situation with moderately poor relations, an unstructured task, and weak position power, also suggests task orientation by the leader, which may reduce the anxiety or ambiguity that could be created by the loosely structured situation. Between the two extremes, the suggested approach emphasizes cooperation and good relations with people.

**Fiedler's research and management** In reviewing Fiedler's research, one finds that there is nothing automatic or "good" in either the task-oriented or the people-oriented style. Leadership effectiveness depends on the various elements in the group environment. This might be expected. Cast in the desired role of leaders, managers who apply knowledge to the realities of the group reporting to them will do well to recognize that they are practicing an art. But in doing so, they will necessarily take into account the motivations to which group members will respond and their ability to satisfy the members in the interest of attaining enterprise goals.

Several scholars have put Fiedler's theory to the test in various situations. Some have questioned the meaning of the LPC score, and others have suggested that the model does not explain the causal effect of the LPC score on performance. Some of the findings are not statistically significant, and situational measures may not be completely independent of the LPC score.

Despite such criticisms, it is important to recognize that effective leadership style depends on the situation. Although this idea may not be new, Fiedler and his colleagues drew attention to this fact and stimulated a great deal of research.

**LEADERSHIP PERSPECTIVE**

## Ratan N. Tata: Leadership at the TATA Group[20]

Ratan Tata is the chairman of the Tata Group, India's biggest conglomerate with the responsibility of guiding the group of some 100 companies. He is a modest person who likes weekend solitude in his own designed beachfront home. With an architectural degree from Cornell University (1962), he is now the architect of big strategies and big deals for the TATA group.

During his travel to China, he was impressed by the rapid economic development which encouraged him to undertake major projects for the Tata Group. For example, he arranged for the investment binge of acquiring the truck unit of South Korea's

Daewoo Motors, hotels, Indonesian coal mines, steel mills in Singapore, Thailand, and Vietnam. He also acquired Tyco International Undersea telecom cables, the Corus Group, the Dutch-British steel giant.

He is considered a tough manager (for example, in dealing with unions) and at the same time, he is promoter of social responsibility. His passion for cars is discussed in conjunction with the now famous $2,500 car discussed elsewhere in this book. The question is: Who will be his successor to continue the leadership role upon Mr. Ratan's retirement?

## The Path–Goal Approach to Leadership Effectiveness

**Path—goal theory** The main function of the leader is to clarify and set goals with subordinates, help them find the best path for achieving the goals, and remove obstacles.

The **path–goal theory** suggests that the main function of the leader is to clarify and set goals with subordinates, help them find the best path for achieving the goals, and remove obstacles. Proponents of this approach have studied leadership in a variety of situations; and as stated by Robert House, the theory builds on various motivational and leadership theories of others.[21]

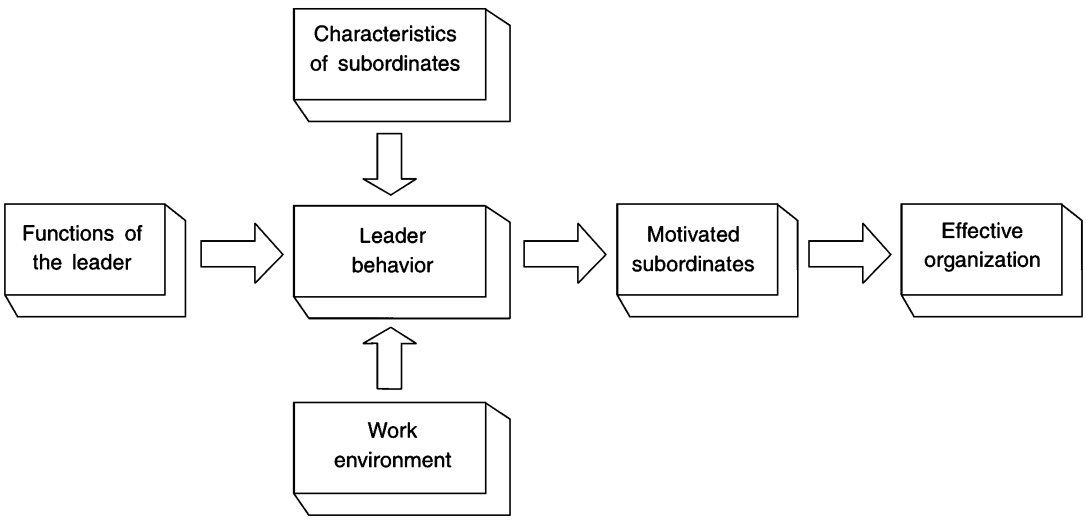
The theory proposes that situational factors contributing to effective leadership should be considered. These factors include (1) the characteristics of subordinates, such as their needs, self-confidence, and abilities; and (2) the work environment, including such components as the task, the reward system, and the relationship with coworkers (see Figure 15.5).

The theory categorizes **leader behavior** into four groups:

1. *Supportive leadership* behavior gives consideration to the needs of subordinates, shows concern for their well-being, and creates a pleasant organiza-

**Figure 15.1**

**Path-Goal Approach to Leadership Effectiveness.**



tional climate. It has the greatest impact on subordinates' performance when they are frustrated and dissatisfied.

2. *Participative leadership* allows subordinates to influence the decisions of their superiors, which may increase motivation.
3. *Instrumental leadership* gives subordinates rather specific guidance and clarifies what is expected of them. It involves aspects of planning, organizing, coordinating, and controlling by the leader.
4. *Achievement-oriented leadership* involves setting challenging goals, seeking improvement of performance, and having confidence that subordinates will achieve high goals.

Rather than suggesting that there is one best way to lead, this theory suggests that the appropriate style depends on the situation. Ambiguous and uncertain situations can be frustrating for subordinates, and a more task-oriented style may be called for. In other words, when subordinates are confused, then the leader may tell them what to do and show them a clear path to goals. On the other hand, for routine tasks, such as those found on the assembly line, additional structure (usually provided by a task-oriented leader) may be considered redundant; subordinates may see such efforts as overcontrolling, which in turn may be dissatisfying. To put it differently, employees want the leader to stay out of their way because the path is already clear enough.

The theory proposes that the behavior of the leader is acceptable and satisfies subordinates to the extent that they see it as a source of their satisfaction. Another proposition of the theory is that the behavior of the leader increases the effort of subordinates—that is, it is motivating—insofar as (1) this behavior makes satisfaction of the needs of subordinates dependent on effective performance and (2) the behavior enhances the subordinates' environment through coaching, directing, supporting, and rewarding.

The key to the theory is that the leader influences the path between behavior and goals. The leader can do this by defining positions and task roles, by removing obstacles to performance, by enlisting the assistance of group members in setting goals, by promoting group cohesiveness and team effort, by increasing opportunities for personal satisfaction in work performance, by reducing stresses and external controls, by making expectations clear, and by meeting members' expectations.

The path–goal theory makes a great deal of sense to the practicing manager. At the same time, one must realize that the model needs further testing before the approach can be used as a definite guide for managerial action.

**Transactional leaders** identify what needs to be done to achieve goals, including clarifying roles and tasks, rewarding performance, and providing for the social needs of followers.

## TRANSACTIONAL AND TRANSFORMATIONAL LEADERSHIP

Managing involves carrying out the managerial functions effectively and efficiently. One of these functions relates to leading in general and to leadership in particular. A distinction can be made between transactional and transformational leaders. **Transactional leaders** identify what subordinates need to do to achieve objectives, clarify organizational roles and tasks, set up an organization structure, reward performance, and provide for the social needs of their followers. Such leaders work hard and try to run the organization effectively and efficiently.

**Transformational leaders** articulate a vision, inspire and motivate followers, and create a climate favorable for organizational change.

www.ibm.com

www.att.com

**Transformational leaders** articulate a vision and inspire followers. They also have the capacity to motivate, shape the organization culture, and create a climate favorable for organizational change. Companies such as IBM and AT&T have programs to promote transformational leadership designed to transform their organizations quickly to respond to the rapid changes in the environment. There are many similarities between transformational leaders and charismatic leaders, with the former being noted for initiating innovation and change. When one thinks of charismatic leaders, one thinks of people such as Winston Churchill, Martin Luther King, and Mother Teresa, who inspired people through her selfless service to the poor.

LEADERSHIP PERSPECTIVE

## Zhang Ruimin Leading the Chinese Haier Group and Wolfgang Bernhard Leading Volkswagen[22]

www.haier.com

Mr. Zhang Ruimin is the founder and CEO of the Haier Group, the most widely recognized home appliances manufacturer in China. Its many products include refrigerators, air-conditioners, freezers, and microwave ovens. During China's Cultural Revolution, Mr. Zhang was sent to work in a metal processing plant, which may have helped him later in leading the appliance firm.

www.ge.com

With the opening of China, Zhang became familiar with Harvard professor Michael Porter's book on competitive strategy, which emphasizes the importance of recognizing customer needs. Moreover, General Electric's approach to quality management and the emphasis on corporate culture illustrated by its CEO, Jack Welch, also influenced Zhang's view of managing.

www.liebherr.com

Quality was Mr. Zhang's major concern. When visiting his refrigerator company, he noted that many of the products were defective. To demonstrate his passion for quality, he had the brand new refrigerators destroyed in a dramatic fashion. Needless to say, the workers were impressed, not only by Zhang's commitment to quality but also by his 14-hour daily work schedule. Uncommon in China at that time, he tied good performance of employees to monetary rewards and promotions. He also adopted other managerial practices learned from his German partner company, Liebherr.

His leadership by example transformed the bureaucratic enterprise into the Haier Group, which is now the best-known Chinese refrigerator company and operates in many countries, including the United States. But a leader cannot rest on accomplishments; a leader must articulate a vision for the future. Guided by Mr. Zhang's foresight, Haier ventured into computers and pharmaceuticals. The entrance of China into the World Trade Organization in 2001 opens opportunities but also presents new challenges for the Haier Group. Mr. Zhang's leadership illustrates that Western management practices can be transferred to countries such as China.

While Mr. Zhan Ruimin may have benefited from German managerial practices, Volkswagen's Top manager Wolfgang Bernhard adopted some managerial

http://www.vw.com

approaches from the Americans. Bernhard received his M.B.A. from the Columbia Business School. He worked for the McKinsey consulting firm and later DaimlerChrysler. He then was hired by Mercedes being put on the fast-track promotion path. When this path was cut short, he got a top management position at Volkswagen being responsible for the VW brand. His task was to reduce the cost and develop new models, a task he did previously at Chrysler. Using his Chrysler experience, he ordered a study that found that VW needed twice the time to assemble a car when compared with its most efficient competitor.

Rather than following the traditional German way of delegating tasks to the appropriate departments, Bernhard assembled 200 VW people in an auditorium with the objective to reduce the costs of the newly planned Sport Utility Vehicle by $2,500. They were not to go back to their workplace until the objective was reached. Each evening, Bernard watched the progress of the teams who worked until late at night to complete their task. After four weeks of hard work, the goal was achieved through team effort. This illustrates that German managers as they gain international experience, can transfer their skills and approaches to their home country.

## SUMMARY

Leadership is the art or process of influencing people so that they contribute willingly and enthusiastically toward group goals. Leadership requires followership. There are various approaches to the study of leadership, ranging from the trait to the contingency approach. One such approach focuses on three styles: autocratic, democratic or participative, and free-rein.

The managerial grid identifies two dimensions: concern for production and concern for people. On the basis of these dimensions, four extreme styles and a "middle-of-the-road" style are identified. Leadership can also be viewed as a continuum. At one extreme of the continuum, the manager has a great deal of freedom, while subordinates have very little. At the other extreme, the manager has very little freedom, whereas subordinates have a great deal.

Still another approach to leadership, built on the assumption that leaders are the product of given situations, focuses on the study of situations. Fiedler's contingency approach takes into account the position power of the leader, the structure of the task, and the relations between the leader and group members. The conclusion is that there is no one best leadership style and that managers can be successful if placed in appropriate situations. The path–goal approach to leadership suggests that the most effective leaders help subordinates achieve enterprise as well as personal goals. Transactional leaders clarify roles and tasks, set up a structure, and help followers achieve objectives. Transformational leaders articulate a vision, inspire others, and transform the organization. Transformational and charismatic leadership concepts are similar.

## KEY IDEAS AND CONCEPTS FOR REVIEW

- ✔ Leadership
- ✔ Ingredients of leadership

- ✔ Principle of leadership
- ✔ Leadership traits
- ✔ Charismatic leadership
- ✔ Leadership styles based on the use of authority
- ✔ Managerial grid
- ✔ Leadership as a continuum
- ✔ Situational approach to leadership
- ✔ Fiedler's contingency theory
- ✔ Path-goal approach to leadership
- ✔ Transactional leader
- ✔ Transformational leader

## FOR DISCUSSION

1. What do you see as the essence of leadership?
2. How are leadership theory and styles related to motivation?
3. Why has the trait approach as a means of explaining leadership been so open to question?
4. Can you see why the managerial grid has been so popular as a training device?
5. Select a business or political leader whom you admire, and identify his or her style of leading by applying the managerial grid or the continuum-of-behavior model of Tannenbaum and Schmidt.
6. What is Fiedler's theory of leadership? Applying it to cases of leaders whom you have known, do you perceive it as being accurate?
7. What are the advantages and limitations of the path–goal approach to leadership?
8. If you were selected to be the group leader for a class project (e.g., to make a case study of a particular company), which leadership style or what behavior would you use? Why?

## EXERCISES/ACTION STEPS



1. Analyze a situation in which you were the leader. Which leadership approach discussed in this chapter helps explain why you were a leader?
2. Analyze a case in this book using the group approach. Specifically, the class should be divided into groups of about five students. Each group should select a spokesperson, who will present the case analysis to the class. For each group, one observer (this person should not be a participant in the case discussion) should describe the interactions in the group. Was there a leader in the group? If the answer is yes, why was he or she considered a leader? Was it owing to his or her personality, the other group members (followers), or the nature of the task (situation)? Explain the group processes in light of any leadership theory or concepts discussed in this chapter.

## INTERNET RESEARCH

1. Use any search engine to find sources for the term "business leadership." Do you find different views on leadership?
2. Jack Welch of General Electric is considered by many an effective leader and manager. Scan the Internet for "Jack Welch" and identify his leadership behavior.

**Leadership Case**

## Profiles of Two Visionaries: Bill Gates and Steve Jobs[23]

Two men who gave their hearts and souls to developing their visions have driven the personal computer (PC) revolution. However, the way in which each of these men went about this quest has been different. Steve Jobs and Bill Gates have changed the way the world does business, but the story of their leadership styles is even more compelling than the success and innovation spawned by Apple and Microsoft.

### Bill Gates versus Steve Jobs: The Early Years

Bill Gates started developing his computer skills with childhood friend Paul Allen at Lakeside School in Seattle. At the age of 14, the two had formed their first computer company. After high school, Allen and Gates left Seattle for Boston. Gates went off to Harvard and Allen began working for Honeywell. After only two years at Harvard, Gates and Allen left Boston for Albuquerque to develop a computer language for the new Altair 8080 PC. This computer language would become BASIC and the foundation for Microsoft, which was created as a partnership in 1975.

After five years in New Mexico, Microsoft relocated to Bellevue, Washington, in 1980 with BASIC and two other computer languages (COBOL and FORTRAN) in its arsenal. Later that year, IBM began developing its first PC and was in need of an operating system. Microsoft developed the Microsoft disk operating system (MS-DOS) for IBM while two other companies created competing systems. Gates's determination and persuasion of other software firms to develop programs for MS-DOS made it the default IBM platform.

As Microsoft became more successful, Gates realized that he needed help managing the company. His enthusiasm, vision, and hard work were the driving force behind the company's growth, but he recognized the need for professional management. Gates brought in one of his friends from Harvard, Steve Ballmer. Ballmer had worked for Proctor & Gamble after graduating from Harvard and was pursuing his MBA at Stanford. Gates persuaded Ballmer to leave school and join Microsoft. Over the years, Ballmer has become an indispensable asset to both Gates and Microsoft. In 1983, Gates continued to show his brilliance by hiring Jon Shriley, who brought order to Microsoft and streamlined the organization structure, while Ballmer served as an advisor and sounding board for Gates. Microsoft continued to grow and prosper in the 1990s, dominating both the operating system market with its Windows and the office suite software market with Microsoft Office.

Gates recognized that his role was to be the visionary of the company and that he needed professional managers to run Microsoft. He combined his unyielding determination and passion with a well-structured management team to make Microsoft the giant it is today.

The other visionary, Steve Jobs, and his friend Steve Wozniak started Apple Computer in Jobs's garage in Los Altos, California, in 1976. In contrast to Bill Gates, Jobs and Wozniak were hardware experts and started with a vision for a personal computer that was affordable and easy to use. When Microsoft offered BASIC to Apple, Jobs immediately dismissed the idea on the basis that he and Wozniak could create their own version of BASIC in a weekend. This was typical Jobs: decisive and almost maniacal at times. Jobs eventually agreed to license Microsoft's BASIC while pursuing his own vision of developing a more usable and friendly interface for the PC.

Many see Jobs as the anti-Gates. He is a trailblazer and a creator as opposed to Gates, who is more of a consolidator of industry standards. Jobs's goal was to change the world with his computers. He was also very demanding of his employees. Jobs was different from Gates, Allen, and Wozniak. He was not a hard-core computer programmer. He was the person selling the idea of the PC to the public. Jobs made the decision to change the direction of Apple by developing the Macintosh (Mac) using a new graphical user interface that introduced the world to the mouse and on-screen icons. Jobs forced people to choose between the Microsoft–IBM operating system and his Mac operating system. In the beginning, Jobs was the visionary who changed the computer world, and Apple dwarfed Microsoft. With all this success, a major problem was brewing at Apple: Steve Jobs was overconfident and did not see Gates and Microsoft as a serious threat to Apple.

Soon after the release of the Macintosh computer, Jobs asked Microsoft to develop software for the Mac operating system. Gates obliged and proceeded to launch a project copying and improving Apple's user interface. The result of that venture was Microsoft Windows.

This cocky attitude and lack of management skills made Jobs a threat to Apple's success. He never bothered to develop budgets, and his relationship with his employees was criticized. Wozniak left Apple after the release of the Mac because of differences with Jobs. In 1985, John Scully, CEO of PepsiCo, replaced Steve Jobs as president and CEO of Apple Computer.

## Microsoft and Apple at the Turn of the Century: An Industry Giant and a Revitalized Leader

With the success of Windows, the Office application suite, and Internet Explorer, Microsoft has become a household name and Bill Gates has been hailed as a business genius. The fact that Microsoft's competitors, the press, and the U.S. Justice Department have called Microsoft a monopoly reinforces Gates's determination to succeed. Many people question whether Microsoft could survive the Justice Department's decision. Bill Gates, however, has shown that he is the master of adapting to changing market conditions and technologies.

Apple has gone in the opposite direction in the 1990s. The outdated operating system and falling market share eventually led to a decrease in software development for the Mac. Something needed to be done. In 1998, Steve Jobs returned to Apple as the "interim" CEO. His vision, once again, resulted in the innovative iMac. The design is classic Jobs. In the 1980s, he created the simple-to-operate Mac to attract people who were using IBM PCs and their clones. Now he has developed a simple, stylish, and Internet-friendly computer to add some much-needed excitement to the computer market. Jobs had also changed as a manager and a leader. He has matured and looked to his professional staff for advice and ideas. Although he is the interim CEO, Jobs has sold all but one share of his Apple stock. Larry Ellison, Oracle's CEO and Apple board member, attributes Jobs's ability to lead Apple to this fact: "He owns only one share of

Apple stock, yet he clearly owns the product and the idea behind the company. The Mac is an expression of his creativity, and Apple as a whole is an expression of Steve. That's why, despite the 'interim' in his title, he'll stay at Apple for a long time."[24] Many people believe that this will lead to continued success for Apple and a renewed battle between Gates and Jobs.

## Gates and Jobs in 2011[25]

While the battle between Apple and Microsoft continues, Steve Jobs passed away in October 2011 and Bill Gates stepped down as CEO in the year 2000 and is now occupied with his philanthropic work at the Bill & Melinda Gates Foundation. Steve Jobs will be remembered like other pioneers such as Henry Ford and Thomas Edison that had a major impact on our lives.

**Questions**

1. How did Bill Gates and Steve Jobs differ in their leadership style?
2. Compare and contrast the managerial practices of Gates and Jobs.
3. What do you think about the future of Microsoft and Apple Computer?

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# MAJOR PRINCIPLES OR GUIDES FOR THE MANAGERIAL FUNCTION OF LEADING

As mentioned in the Part Closings for planning, organizing, and staffing, experience, and observation of managing indicate certain fundamental managerial principles or guides.

Each principle has a letter that represents the type of managerial function. The letter "L" in front of the principles indicated that it pertains to the managerial function of leading.

## Major Principles or Guides for Leading

The managerial function of leading can be summarized by several principles or guides.

L1. *Principle of harmony of objectives*. The more managers can harmonize the personal goals of individuals with the goals of the enterprise, the more effective and efficient the enterprise will be.

L2. *Principle of motivation*. Since motivation is not a simple matter of cause and effect, the more managers carefully assess a reward structure, look upon it from a situational and contingency point of view, and integrate it into the entire system of managing, the more effective a motivational program will be.

L3. *Principle of leadership*. Since people tend to follow those who, in their view, offer them a means of satisfying their personal goals, the more managers understand what motivates their subordinates and how these motivators operate and the more they reflect this understanding in carrying out their managerial actions, the more effective they are likely to be as leaders.

For organizational communication to be effective, managers should take note of the following principles:

L4. *Principle of communication clarity*. Communication tends to be clear when it is expressed in a language and transmitted in a way that can be understood by the receiver.

L5. *Principle of communication integrity*. The greater the integrity and consistency of written, oral, or nonverbal messages, as well as of the moral behavior of the sender, the greater the acceptance of the message by the receiver.

L6. *Principle of supplemental use of informal organization*. Communication tends to be more effective when managers utilize the informal organization to supplement the communication channels of the formal organization.

The sender has the responsibility to formulate the message so that it is understandable to the receiver. This responsibility pertains primarily to written and oral communication and points to the necessity for planning the message, stating the underlying assumptions, and applying the generally accepted rules for effective writing and speaking.

Informal organization is a phenomenon managers must accept. Information, true or not, flows quickly through the informal organization. Consequently, managers should take advantage of this device to correct misinformation and to provide information that cannot be effectively sent or appropriately received through the formal communication system.

# 16 Committees, Teams, and Group Decision-Making

## CHAPTER OBJECTIVES

After studying this chapter, you should be able to:

- Explain the nature of various types of committees and groups
- Outline the reasons why committees and groups are used with special attention to their use in decision-making*
- Present the disadvantages of committees, especially in decision-making
- Discuss the requirements for using committees effectively
- Explain various group concepts
- Understand the nature of teams, team building, self-managing teams, and virtual teams
- Recognize conflict in committees, groups, and organizations

**Committee** A group of persons to whom, as a group, some matter is committed.

One of the most ubiquitous devices of organization is the committee. Whether it is referred to as a board, commission, task force, team, self-managing team, self-managed work group, or autonomous work group, it's essential nature is similar. A **committee** is a group of persons to whom, as a group, some matter is committed. It is this characteristic of group action that sets the committee and team apart from other organizational devices, although, as will be seen, not all committees involve group decision-making. As shown later in this chapter, the definition of *team* is similar. Therefore, much of the discussion of committees also pertains to teams, although this term may not be repeatedly used.



## THE NATURE OF COMMITTEES AND GROUPS

Because of variation in the authority assigned to committees, much confusion has resulted as to their nature.

Four stages of group development: forming, storming, norming, and performing.

### Group Processes in Committees

Some say that groups go through four stages: (1) *forming*, when the members of the group get to know each other; (2) *storming*, when the members of the group

*Decision-making is also discussed in Chapter 6.

determine the objective of the meeting and conflict arises; (3) *norming*, when the group agrees on norms and some rules of behavior; and (4) *performing*, when the group gets down to the task. While these characteristics may be found in most groups, they may not necessarily follow these sequential steps.

People play certain roles in committees. Some seek information; others give information. Some try to encourage others to contribute; others are followers. Finally, some try to coordinate the group's effort or to achieve a compromise when disagreements occur, while others take a more aggressive role.

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To be effective in a group, one must not only listen to what is said but also observe the nonverbal behavior. Furthermore, noting the seating of members may give clues as to the social bonds among the group participants. Those who know each other often sit next to one another. The seating arrangement may have an impact on the group interaction. Often the chairperson sits at the head of a rectangular table. However, at Daimler-Benz, the maker of Mercedes-Benz cars, the board of directors sits at a round table to de-emphasize the position of the chairperson.

## Functions and Formality of Committees and Groups

Some committees and teams undertake the managerial functions of planning, organizing, staffing, leading, and controlling, while others do not. Some make decisions, while others merely deliberate on problems without authority to decide. Some have authority to make recommendations to a manager, who may or may not accept them, while others are formed to receive information, without making recommendations or decisions.

**Plural executive** A line committee that also carries out managerial functions, such as the board of directors.

A committee may have either line or staff functions, depending on its authority. If its authority involves decision-making affecting subordinates it is responsible for, it is a **plural executive**—a *line committee* that also carries out managerial functions, such as the board of directors. If its authority relationship to a superior is advisory, then it is a *staff committee*.

**LEADERSHIP PERSPECTIVE**

## Corporate Governance[1]

http://www.tyco.com

http://en.wikipedia.org/wiki/WorldCom

http://www.enron.com

Recently, the boards of directors in U.S. companies have come under intense scrutiny by the Securities and Exchange Commission and other groups because of accounting impropriety at organizations such as Tyco (a conglomerate), WorldCom (a telecommunication company), and Enron (an energy trader) that led to two of the largest bankruptcy cases in U.S. history. There is a call for strengthening the board of directors, a plural executive committee. Among the recommendations by various groups are the following:

- Change the accounting standards and audit regulations.
- Publish ethical and corporate governance guidelines on the company's website.
- Strengthen the role of independent directors.

- Make the board accountable to shareholders and involve shareholders in selecting board members.
- Obtain greater involvement of institutional investors (such as pension fund managers).
- Separate the job of the chairperson from that of the chief executive officer (CEO).
- Get the board more actively involved in selecting the CEO.

Other countries are also reviewing corporate governance. For example, German companies have two boards. The supervisory board provides oversight, while the management board is responsible for managing the firm. Recently, there is a drive to publish the pay of top managers, which in the past was considered a private matter. There is also the push to increase the supervisory board's supervision of the activities of the management board. In France and Italy, the governance issue has not yet become a major issue. For example, in the Italian Fiat Company, families hold a large portion of shares. Still, the publicity on corporate scandals may raise awareness of the role of corporate governance.

Committees may also be formal or informal. If established as part of the organization structure, with specifically delegated duties and authority, they are *formal*. Most committees with any permanence fall into this class. Committees that are *informal* are organized without specific delegation of authority, usually by some person desiring group thinking or a group decision on a particular problem. For example, a manager may have a problem on which he or she needs advice or agreement from other managers or specialists outside his or her department. The manager may therefore call a special meeting for the purpose of solving the problem.

Committees may be relatively *permanent*, or they may be *temporary*. One would expect formal committees to be more permanent than the informal ones, although this is not necessarily so. A formal committee might be established by order of a company president, with appropriate provision in the organization structure, for the sole purpose of studying the advisability of building a new factory and be disbanded immediately upon the completion of its task. And an informal committee set up by the factory manager to advise on the improvement of product quality or to help coordinate delivery dates with sales commitments might continue indefinitely.



## REASONS FOR USING COMMITTEES AND GROUPS

One need not look far for reasons for the widespread use of committees and teams. Although the committee is sometimes regarded as having democratic origins and as being characteristic of democratic society, the reasons for its existence go beyond mere desire for group participation. Committees are widely used even in authoritarian organizations.

## Group Deliberation and Judgment

Perhaps the most important reason for the use of committees is the advantage of gaining group deliberation and judgment—a variation of the adage that "two heads are better than one." Very few important business problems fall entirely into one single enterprise function such as production, engineering, finance, or sales. Most problems require more knowledge, experience, and judgment than any individual possesses.

It should not be inferred that group judgment can be obtained only through the use of committees. The staff specialist who confers individually with many persons in a given phase of a problem can obtain group judgment without the formation of a committee. Similarly, an executive may ask key subordinates or other specialists for their analyses and recommendations. At times, group judgment can be obtained more efficiently this way, in terms of time, than by using the deliberations of a committee.

## Fear of Too Much Authority in a Single Person

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www.house.gov
www.whitehouse.gov

Another reason for the widespread use of committees is the fear of delegating too much authority to a single person. This fear, especially pronounced in government, dictated to the framers of the American Constitution not only the establishment of a two-house legislature and a multimember Supreme Court but also the division of the powers of government among the Congress, the Supreme Court, and the President. Despite this fear of centralized authority, the founders of the American republic placed the administration of laws in the hands of a single top executive. Yet, as President Nixon discovered, the legislature has the power to remove, or force the resignation, of the chief executive.

## Representation of Interested Groups

Representation plays a part in the establishment and staffing of committees. Boards of directors are often selected on the basis of groups interested in the company and, perhaps more often, on the basis of groups in which the company has an interest. When executives have a particularly difficult internal problem involving managers and specialists in various departments and activities, they may choose members in such a way as to give these interested parties representation.

## Coordination of Departments, Plans, and Policies

There is general agreement that committees are very useful for coordinating activities among various organizational units. They are also useful for coordinating plans and policies as well as their implementation. The dynamics of modern enterprises place a heavy burden on the managers to integrate plans and activities. A committee permits individuals not only to obtain first-hand knowledge of the plans and of their own role in the execution of them, but also to make suggestions for the improvement of plans.

### Transmission and Sharing of Information

Committees are useful for transmitting and sharing information. All group members affected by a mutual problem or project can learn about it simultaneously, and decisions and instructions can be received uniformly with opportunities for clarification. This may save time. The spoken word may clarify a point better than even carefully written memorandums.

### Consolidation of Authority

A manager in a department, branch, or section often has only a portion of the authority necessary to accomplish a program. This is known as *splintered authority*. One way to handle a problem in this situation is to refer it upward in the organizational hierarchy until it reaches a point at which the requisite authority exists. But this place is often in the office of the president, and the problem may not be of sufficient importance to be decided at that level.

For example, a customer of a machine tool manufacturer may wish a slight but unusual change in the design of a piece of equipment. The customer approaches the sales department, which (if there is no established procedure for handling this change) cannot act without the authority of the engineering, production, and cost estimating departments. In such a case, the sales manager might establish a special purpose team to study the problem, to agree on the nature and cost of the change, and to use the combined authority of its members to approve the request.

The informal use of committees gives much flexibility to an organization. However, consolidating splintered authority through a committee should be considered carefully. It should be determined whether the organization structure itself should be changed in order to concentrate in one position the appropriate authority to make recurring decisions.

### Motivation through Participation

Committees permit wide participation in decision-making. People who take part in planning a program or making a decision usually feel more enthusiastic about accepting and executing it. Even limited participation can be helpful.



## DISADVANTAGES AND MISUSE OF COMMITTEES

Although there are good reasons for using committees, there are also disadvantages of doing so. They are costly. They may result in compromises at the least common denominator rather than in an optimal decision. They may lead to indecision. They also can split responsibility. Finally, they can lead to a situation in which a few persons impose their will on the majority, not allowing participation of other members.

The committee form has often fallen into disrepute through misuse. In general, committees should not be used as a replacement for a manager, for research study, for unimportant decisions, and for decisions beyond the participants' authority.

LEADERSHIP PERSPECTIVE

### What People Say about Committees

Disparaging attitudes toward committees are reflected in such sayings as the following:

- "A camel is a horse invented by a committee."
- "A committee is made up of the unfit selected by the unwilling to do the unnecessary."
- "A committee is a place where the loneliness of thought is replaced by the togetherness of nothingness."

## SUCCESSFUL OPERATION OF COMMITTEES AND GROUPS

Managers spend a great deal of time in committees. The use of committees is due not only to the democratic tradition but also to a growing emphasis on group management and group participation in organizations. In attempting to overcome some of the disadvantages of committees, managers may find the following guidelines useful.

### Authority

A committee's authority should be spelled out so that its members know whether their responsibility is to make decisions, make recommendations, or merely deliberate and give the chairperson some insights into the issue under discussion.

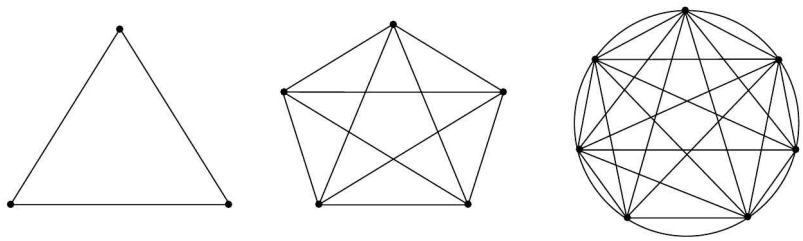
### Size

The complexity of interrelationships greatly increases with the size of the group.

The size of a committee is very important. As shown in Figure 16.1, the complexity of interrelationships greatly increases with the size of the group. If the group is too large, there may not be enough opportunities for adequate communication among its members. On the other hand, if the group consists of only three persons, there is the possibility that two may form a coalition against the third member. No

**Figure 16.1**

**Increased Complexity of Relationships Through Increase in Group Size.**



precise conclusions can be drawn here about the appropriate size. As a general rule, a committee should be large enough to promote deliberation and include the breadth of expertise required for the job, but not so large as to waste time or foster indecision. It is obvious that the larger the group, the greater the difficulty in obtaining a "meeting of the minds" and the more time needed to allow everyone to contribute.

## Membership

The members of a committee must be selected carefully. If a committee is to be successful, the members must be representative of the interests they are expected to serve. They must also possess the required authority and be able to perform well in a group. Finally, the members should have the capacity for communicating well and reaching group decisions by integrated group thinking rather than by inappropriate compromise.

## Subject Matter

The subject must be carefully selected. Committee work should be limited to subject matter that can be handled in group discussion. Certain kinds of subjects lend themselves to committee action while others do not. Jurisdictional disputes and strategy formulation, for example, may be suitable for group deliberation, while an expert in the relevant specialized field may better solve certain isolated, technical problems. Committees will be more effective if an agenda and relevant information are circulated well in advance so that members can study the subject matter before the meeting.

## Chairperson

The selection of the chairperson is crucial for an effective committee meeting. Such a person can avoid the wastes and drawbacks of committees by planning the meeting, preparing the agenda, seeing that the results of research are available to members ahead of time, formulating definite proposals for discussion or action, and conducting the meeting effectively. The chairperson sets the tone of the meeting, integrates the ideas, and keeps the discussion from wandering.



## Minutes

Effective communication in committees usually requires circulating minutes and checking conclusions. At times, individuals leave a meeting with varying interpretations as to what agreements were reached. This can be avoided by taking careful minutes of the meeting and circulating them in draft form for correction or modification before the committee approves the final copy.

## Cost-Effectiveness

A committee must be worth its costs. It may be difficult to count the benefits, especially such intangible factors as morale, enhanced status of committee members,

and the committee's value as a training device to enhance teamwork. But the committee can be justified only if the costs are offset by tangible and intangible benefits.

## ADDITIONAL GROUP CONCEPTS[2]

Although the committee is of special importance as an organizational device, it is really only one of many types of groups that are found in organizations. In addition to committees, there are teams, conferences, task forces, and negotiation sessions, all involving group activities.

**Group** Two or more people acting interdependently in a unified manner toward the achievement of common goals.

A **group** may be defined as two or more people acting interdependently in a unified manner toward the achievement of common goals. A group is more than a collection of individuals; rather, through their interactions, new forces and new properties are created that need to be identified and studied in themselves. The goals may pertain to specific tasks, but they may also mean that the people share some common concerns or values or an ideology. Thus, group members are attracted to each other by some social bonds.

### Characteristics of Groups

Groups—and the focus is on groups in an organization—have a number of characteristics. First, group members share one or more common goals, such as the goals of a product group to develop, manufacture, and market a new product. A second characteristic of groups is that they normally require interaction and communication among members. It is impossible to coordinate the efforts of group members without communication. Third, members within a group assume roles. In a product group, various individuals are responsible for designing, producing, selling, or distributing a product. Naturally, the roles are in some kind of relationship to each other in order to achieve the group task. Fourth, groups usually are a part of a larger group. The product group may belong to a product division that produces many products of a similar nature. Large groups may also consist of subgroups. Thus, within the product group may be a subgroup specializing exclusively in the selling of the product. Also, groups interface with other groups. Thus, product group A may cooperate with product group B in the distribution of their products. It is evident, then, that the systems point of view, which focuses on the interrelatedness of parts, is essential in understanding the functioning of groups.

**Norms** The expected behavior of group members.

There are a number of other sociological characteristics of groups that must be recognized. Groups develop **norms**, which refer to the expected behavior of the group members. If individuals deviate from the norms, pressure is exerted to make them comply. This can be functional when, for example, a person who frequently shows up late for work is admonished by other group members. But there are also situations in which groups may be dysfunctional. For example, ambitious, highly motivated employees may be pressed to produce in congruence with generally accepted norms rather than according to their abilities.

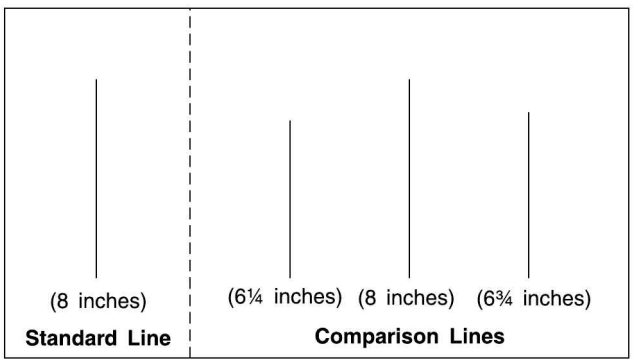
LEADERSHIP PERSPECTIVE

## Pressure toward Conformity: How Would You Respond?

In a widely publicized experiment, S. E. Asch showed the impact of group pressure toward conformity.[3] Members of a small group were asked to match a standard line (8 inches long) with three comparison lines (6¼, 8, and 6¾ inches long) (see Figure 16.2). One member of the group (the naive subject) was not aware that all the other students in the group (confederates of the experimenter) were instructed to occasionally give wrong answers, such as saying that the 6¾-inch line was as long as the 8-inch standard line. The setting was arranged so that the naive subject was one of the last ones to make a judgment. It was found that an "innocent" member made wrong choices when the confederates did so unanimously. In later interviews, subjects reported that they wanted to agree with the majority. This illustrates that, even in a rather uncomplicated task, people may decide against their better judgment owing to group pressure. These findings explain to some extent the influence of group pressure toward conformity and how it may result in managerial decisions that are less than optimal.

**Figure 16.1**

**Which Comparison Line is the Same Length as the Standard Line?**




## A Special Kind of Group: The Focus Group

Focus groups have been used for some time in market research. For example, actual or potential customers are asked in a group setting to comment on a product or service before large-scale research is undertaken. The comments may be taped or notes may be taken. The responses are then analyzed to determine the customers' attitudes, perceptions, or satisfaction with regard to the product or service.

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Elements of focus groups have also been used in Europe. Germany's public participated in value forums to determine long-term energy policies. The experience indicated that the public can contribute to value forums, the participants were satisfied with this kind of procedure, and they were eager to help resolve inconsistencies.

Focus groups may also be used for evaluating managerial aspects within an organization. The Public Service Company of New Mexico established six focus groups to elicit responses about its performance appraisal, compensation, and benefits systems. On the basis of the findings, the company implemented a more flexible benefits program, a job redesign program, and a new decision-making process. Rather than imposing organizational changes, the company allowed the employees to become actively involved in the change process.

## Functions and Advantages of Groups[4]

Groups have many functions. They are powerful in changing behavior, attitudes, and values and in disciplining members. As noted, deviant members may be pressured to adhere to group norms. In addition, groups are used for decision-making, negotiating, and bargaining. Thus, group members with diverse backgrounds may bring different perspectives to the decision-making process. This does not mean, however, that group decisions are always better than individual decisions.

Group concepts are very important for the topics covered in other chapters in this book. Specifically, different group structures influence *communication* patterns. Thus, communication will differ when it is channeled through one key member or when it flows freely among all the group members. One can hardly consider a number of people a team when each member communicates only with the boss; teamwork requires open communication among all members. Effective group interaction may also affect *motivation*. For example, group members participating in setting objectives may become committed to the achievement of group goals. Finally, *leadership* must be seen in the context of group processes. A grasp of group concepts helps in understanding the interactions between leaders and followers as well as among all the group members. In short, an understanding of groups is important for carrying out all managerial functions, particularly the function of leading. Groups are a fact of organized and unorganized life. It is important to know how they work and to use them in an effective and efficient manner in situations that favor group actions.

Groups also have advantages for individuals. Groups do provide social satisfaction for their members, a feeling of belonging, and support for the needs of individuals. Another benefit of groups is that they promote communication. It may be the give-and-take in a formal meeting, or it can take the form of the grapevine, which is the informal communication through which group members become aware of "what is really going on in the organization." Groups also provide security. Labor unions are sometimes formed precisely for this reason—to give job security to their members. Finally, groups provide opportunities for promoting self-esteem through recognition from and acceptance by peers.

**Team** A small number of people with complementary skills, who are committed to a common purpose, set of performance goals, and approach for which they hold themselves mutually accountable.

## TEAMS[5]

A team consists of a number of people who are empowered to achieve team goals. As mentioned at the beginning of the chapter, committees, groups, and teams have similar characteristics. A **team** can be defined as "a small number of people with complementary skills who are committed to a common purpose, set of performance

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goals, and approach for which they hold themselves mutually accountable."[6] As with committees, there are different types of teams. Some make recommendations, others have the power to make decisions, and still others actually run operations. Some teams are created to solve problems, such as quality circles; others engage in activities that cross-functional areas, such as design, marketing, finance, manufacturing, personnel, and so on. Such cross-functional teams may be used for developing a new product or to improve the quality of a product or service. For example, in the design and development of the Boeing 777 airliner, some 200 cross-functional teams were involved. It is clear that what has been said about committees also applies to teams.

## Team Building[7]

There are no definite rules for building effective teams. The following approaches, however, were found to be useful. Team members must be convinced that the team's purpose is worthwhile, meaningful, and urgent. Team members should also be selected according to the skills needed to achieve the purpose. Teams should have the right mix of skills, such as functional or technical skills, problem-solving and decision-making skills, and of course human relations skills. The team needs to be guided by rules for group behavior, such as regular attendance, confidentiality, discussions based on facts, and everyone contributing. Goals and required tasks should be identified early in team formation. Members should encourage each other through recognition, positive feedback, and rewards.

## Self-managing Teams[8]

**Self-managing team** A group with members who have a variety of skills needed to carry out a relatively complete task.

Recently, organizations have used **self-managing teams**, which usually consist of members who have a variety of skills needed to carry out a relatively complete task. Thus, such a team may have the power to determine what needs to be done, how it will be done, when it needs to be completed, and who is going to do it. Team members may also be evaluated and rewarded as a group. Especially when the team has a great deal of power, it may be called a *high-performance team* or even a *super team*.

## Virtual Teams

**Virtual management** Running a team whose members are not in the same location, do not report to the person managing it, and may not even work for the same organization.

In the rapidly changing environment, a company has to respond fast to take advantage of opportunities. This, in turn, may require **virtual management**, which has been described as "the ability to run a team whose members aren't in the same location, don't report to you, and may not even work for your organization."[9] Not being in the same location and not even reporting to the same superior make managing those teams even more difficult. Therefore, it is important to have a clear purpose, to define clearly the tasks and assumptions, and to communicate effectively by such means as e-mail, fax, telephone, and perhaps even a project website. It is also essential to carefully watch for possible conflict so that it can be resolved quickly.

## CONFLICT IN COMMITTEES, GROUPS, AND TEAMS[10]

Conflict may arise between individuals, between groups, and between the organization and its environment.

Despite the many advantages of committees, groups, and teams, conflict will arise. In the discussion of committees, we pointed out the disadvantages of committees; they also apply to groups and teams. In addition, there is a great deal of literature dealing with work group and team conflict.[11] Conflict may arise between individuals (interpersonal conflict), between groups (intergroup conflict), and between the organization and its environment, such as with other organizations. There can also be resentment toward "free riders," individuals who do not contribute their fair share yet share in group rewards.

## SUMMARY

A committee is a group of persons to whom, as a group, some matter is committed. Committees may be line or staff, formal or informal, permanent or temporary. Committees are used for obtaining group deliberation and judgment, for preventing one person from accumulating too much authority, and for presenting the views of different groups. Committees are also used for coordinating departments, plans, and policies as well as for sharing information. At times, a manager may not have all the authority needed for making a decision; authority is therefore consolidated through committees. Moreover, committees often increase motivation by letting people participate in the decision-making process.

Committees also have disadvantages: they can be costly, their actions may result in compromises at the least common denominator, their discussions may lead to indecisions, and they have the tendency to be self-destructive when one person dominates the meetings. Another drawback is that responsibility is split, with no one person feeling responsible for a decision. Moreover, a small group of committee members may insist on the acceptance of their unwarranted view against the will of the majority.

Effective operation of a committee requires determining its authority, choosing an appropriate size, selecting members carefully, using it only for the proper subject matter, appointing an effective chairperson, taking and circulating minutes, and using it only when its benefits exceed its costs.

The experiment by Asch shows the impact of group pressure toward conformity. The focus group is a special kind of group that elicits responses from customers, the public, or employees. Before an organization uses group actions, it must consider the advantages and disadvantages of groups. A committee is one kind of group; another kind is a team. In the self-managing team, members have a variety of skills needed to carry out relatively complete tasks. In virtual management, team members are not in the same place, do not report to the same superior, and may not work for the same organization. With the wide use of committees, groups, and teams, interpersonal and intergroup conflict may arise. In addition, conflict between organizations as well as between organizations and their environments needs to be dealt with.

## KEY IDEAS AND CONCEPTS FOR REVIEW

- ✔ Committee
- ✔ Four stages in group processes

- ✔ Plural executive and board of directors
- ✔ Line and staff committees
- ✔ Formal and informal committees
- ✔ Permanent and temporary committees
- ✔ Reasons for using committees
- ✔ Disadvantages and misuse of committees
- ✔ Recommendations for making committees successful
- ✔ Characteristics of groups
- ✔ Norms
- ✔ Asch's experiment on group pressure
- ✔ Focus group
- ✔ Functions and advantages of groups
- ✔ Team and team building
- ✔ Self-managing team
- ✔ Virtual team
- ✔ Conflict in committees, groups, and teams

## FOR DISCUSSION

1. A prominent novelist-critic of the management scene has said: "I don't think we can go on very much longer with the luxurious practice of hiring ten men to make one man's decision. With all its advantages, professional management tends to encourage bureaucratic corpulence." Comment.
2. Distinguish between a committee, a team, and a group.
3. What are the reasons for using committees? If there are good reasons, why are committees criticized so much?
4. What is the relative effectiveness of individual and committee action in functional activities? Identify the activities that can be undertaken most effectively by a committee.
5. Describe and discuss the nature of misapplications of committees.
6. What would you recommend for making committees effective?
7. Go to the Internet and find out what has been written about team management.
8. What are the major characteristics of groups in organizations?



## EXERCISES/ACTION STEPS

1. Discuss the case in this chapter in groups. Divide the class into groups of various sizes (e.g., groups of 3, 6, 9, and 12 students). Each group is to analyze the case and make recommendations. A spokesperson should be selected in each group to present the group's view on the case. On what basis was the spokesperson selected? What are the similarities and differences between a spokesperson and a chairperson? Discuss the advantages and problems encountered in the groups of various sizes. What do you think is the ideal group size?
2. Interview two managers and ask about their experiences in committees. Do they have a positive or a negative view of committees? What have they found to be most important for making committees effective and efficient? What do they think is the ideal size of a committee?

## INTERNET RESEARCH

1. Search the Internet for the term "virtual team" and see how companies develop and apply tools for virtual teams in real situations.
2. Search the Internet using the key words "Asch effect" or "Asch experiment." Find out the details of the experiment.

**Leadership Case**

## Could the Challenger Accident Have Been Avoided?[12]

The Challenger space shuttle accident on January 28, 1986, gripped America more than any other event in the last dozen years or so. It was a tragic accident in which seven people died. There is now evidence that the astronauts may have survived the initial explosion and may have died on impact when the space shuttle hit the water. The purpose of recounting the Challenger accident is to briefly explain what happened, possible reasons for why it happened, how it may have been prevented, and what can one learn from it.

The Challenger mission consisted of two complex systems: the technical and the managerial system. The technical problem was the troublesome O-rings, which under pressure and low temperatures became ineffective and did not provide the required seal. Engineers and managers were aware of the problem. So why was the go-ahead given for launching the spacecraft? Can it be explained by the way the managerial system worked?

Engineers at Morton Thiokol, the contractor for the rocket booster, argued against the launch, citing previous problems at low temperatures. Management, on the other hand, may have felt the pressure from NASA to go ahead with the launch. Roger Boisjoly, one of the engineers who argued strongly against the launch, stated that he received looks from management that seemed to say "Go away and don't bother us with the facts." He said that he felt helpless. Another engineer was told to take off his engineering hat and put on his management hat.

Eventually, the go-ahead was given by managers. Engineers were excluded from the final decision. What, then, were some possible reasons for the disaster? Some argued that there was a lack of communication between engineers and managers. They had different goals: safety versus on-time launching. Others suggested that people with responsibilities did not want to hear the bad news. Thus, no listening. Still others suggested that there was insufficient provision for upward communication outside the chain of command. There was also a suggestion that status differences between engineers and managers and between upper- and lower-level managers may have played a role in inhibiting upward communication. Perhaps there was also false confidence in the mission because of past luck. Managers and engineers knew of the problem, but nobody was killed before. Moreover, no one in the organizational unit wanted to be the "bad guy" to halt the launch. Morton Thiokol may also have been concerned about a pending contract.

The result of the series of events was the death of seven Americans: Jarvis, McAuliffe, McNair, Onizuka, Resnik, Scobee, and Smith. The question on our mind is: Could this accident have been prevented?

**Questions**

1. What can you learn from this disaster that may be relevant to your organization or an organization you know?
2. What do you think was the cause, or were the causes, of the Challenger disaster?
3. What do you do if a group decides in a way that is contrary to your judgment? (See Roger Boisjoly in the case.)

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# 17 Communication

## CHAPTER OBJECTIVES

After studying this chapter, you should be able to:

- Describe the purpose of communication and the basic communication process
- Explain the flow of communication in an organization
- Describe the characteristics of written, oral, and nonverbal communication
- Identify barriers and breakdowns in communication and suggest approaches to improve it
- Understand the role of the electronic media in communication

**Communication** The transfer of information from a sender to a receiver, with the information being understood by the receiver.

Although communication applies to all phases of managing, it is particularly important in the function of leading. **Communication** is the transfer of information from a sender to a receiver, with the information being understood by the receiver. This definition forms the basis for the communication process model discussed in this chapter. The model focuses on the sender, the transmission, and the receiver of the message. It also draws attention to "noise," which interferes with good communication, and feedback, which facilitates communication. This chapter also examines the impact of the electronic media on communication.

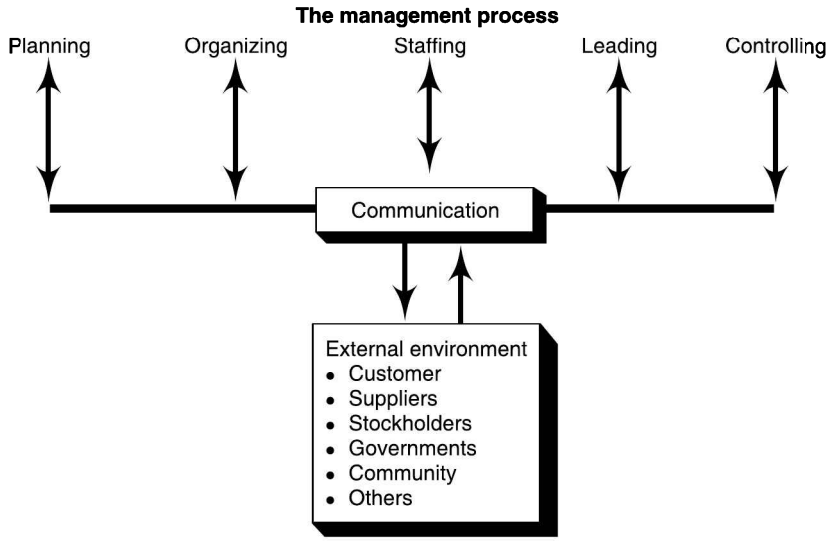
## THE PURPOSE OF COMMUNICATION

In its broadest sense, the purpose of communication in an enterprise is to effect change—to influence action toward the welfare of the enterprise. Communication is essential for the *internal* functioning of enterprises because it integrates the managerial functions. Especially, communication is needed (1) to establish and disseminate the goals of an enterprise; (2) to develop plans for their achievement; (3) to organize human and other resources in the most effective and efficient way; (4) to select, develop, and appraise members of the organization; (5) to lead, direct, motivate, and create a climate in which people want to contribute; and (6) to control performance.

Figure 17.1 graphically shows not only that communication facilitates the managerial functions but also that communication relates an enterprise to its *external* environment. It is through information exchange that managers become aware of the needs of customers, the availability of suppliers, the claims of stockholders, the regulations of governments, and the concerns of the community. It is through

**Figure 16.1**

**The Purpose and Function of Communication.**



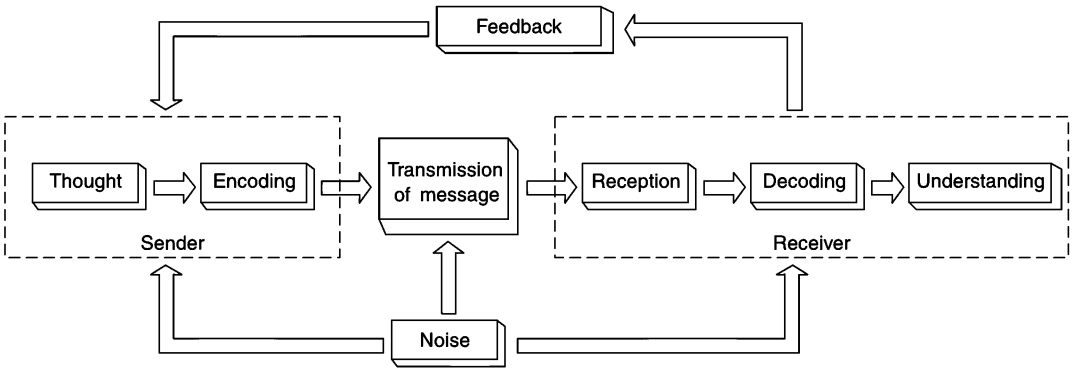

communication that any organization becomes an open system interacting with its environment, a fact whose importance is emphasized throughout this book.

## THE COMMUNICATION PROCESS

Simply stated, the communication process, diagramed in Figure 17.2, involves the sender, the transmission of a message through a selected channel, and the receiver. Let us examine closely the specific steps in the process.

**Figure 16.1**

**A Communication Process Model.**



## Sender of the Message

Communication begins with the sender, who has a *thought* or an idea, which is then encoded in a way that can be understood by both the sender and the receiver. While it is usual to think of *encoding* a message into a spoken language, there are many other ways of encoding, such as translating the thought into computer language.

## Use of a Channel to Transmit the Message

The information is then transmitted over a channel that links the sender with the receiver. The message may be oral or written, and its *transmission* may be through a memorandum, a computer, a telephone, a telegram, e-mail, television, or other media. Television, of course, also facilitates the transmission of gestures and other visual clues. At times, two or more channels are used. In a telephone conversation, for instance, two people may reach a basic agreement that they later confirm by a letter. Since many choices are available, each with advantages and disadvantages, the proper selection of the channel is vital for effective communication.

## Receiver of the Message

The receiver has to be ready for the *reception* of the message so that it can be decoded into thoughts. A person thinking about an exciting football game, for example, may pay insufficient attention to what is being said about an inventory report, thus increasing the probability of a communication breakdown. The next step in the process is *decoding*, in which the receiver converts the message into thoughts. Accurate communication can occur only when both the sender and the receiver attach the same, or at least similar, meanings to the symbols that compose the message. Thus, it is obvious that a message encoded into French requires a receiver who understands French. Less obvious, and frequently overlooked, is the fact that a message in technical or professional jargon requires a recipient who understands such language. So communication is not complete unless it is understood. *Understanding* is in the mind of both the sender and the receiver. Persons with closed minds will normally not completely understand messages, especially if the information is contrary to their value system.



**INTERNATIONAL PERSPECTIVE**

### Cross-Cultural Barriers

Misunderstandings increase when communication is in different languages. The German language, for example, is rather distinct in its formality and the way people are addressed. The formal *Sie* is seldom replaced by *Du*. It is only after people know each other for a long time and only after they know each other very well is the informal *Du* used. Similarly, adults usually address each other with *Herr* (Mr.) or *Frau* (Mrs.). The use of the first name is common only among relatives, very

close friends, or children and teenagers. A non-German who is addressed with the formal *Sie* or the formal *Frau* or *Herr* may interpret such usage as meaning that the person does not like him or her or wants to maintain a social distance. This may not be true at all; the usage is simply dictated by cultural norms. On the other hand, if a German casual acquaintance is addressed in German by his or her first name, that person may be offended. While such distinctions in a language may appear unimportant to a non-German, they not only create communication barriers but also may result in damaged relationships and possibly in a loss of business.

## Noise Hindering Communication

**"Noise"** Anything–whether in the sender, the transmission, or the receiver–that hinders communication.

Unfortunately, communication is affected by "*noise*," which is anything—whether in the sender, the transmission, or the receiver—that hinders communication. Here are examples of "noise":

- A noise or a confined environment may hinder the development of a clear thought.
- Encoding may be faulty because of the use of ambiguous symbols.
- Transmission may be interrupted by static in the channel, such as may be experienced in a poor telephone connection.
- Inaccurate reception may be caused by inattention.
- Decoding may be faulty because the wrong meaning may be attached to words and other symbols.
- Understanding can be obstructed by prejudices.
- A desired change that is communicated may not occur because of the fear of possible consequences of the change.
- In cross-cultural communication, not only verbal expressions but gestures and posture can cause miscommunication as well.

## Feedback in Communication

To check the effectiveness of communication, a person must have *feedback*. One can never be sure whether or not a message has been effectively encoded, transmitted, decoded, and understood until it is confirmed by feedback. Similarly, feedback indicates whether individual or organizational change has taken place as a result of communication.

## Situational and Organizational Factors in Communication

The communication process is affected by many situational and organizational factors.

Many situational and organizational factors affect the communication process. Such factors in the external environment may be educational, sociological, legal–political, and economic. For example, a repressive political environment will inhibit the free flow of communication. Another situational factor is geographic distance. A direct face-to-face communication is different from a telephone conversation with a person on the other side of the globe and different from an exchange of cables or letters. Time must also be considered in communication. The busy executive may not have

The communication model provides an overview of the communication process, identifies the critical variables, and shows their relationships.

sufficient time to receive and send information accurately. Other situational factors that affect communication within an enterprise include the organization structure, managerial and nonmanagerial processes, and technology. An example of the latter is the pervasive impact of computer technology on the handling of huge amounts of data.

In summary, the communication model provides an overview of the communication process, identifies the critical variables, and shows their relationships. This in turn helps managers pinpoint communication problems so that they can take steps to solve them or, even better, prevent the difficulties from occurring in the first place.

## COMMUNICATION IN THE ORGANIZATION

In today's enterprises, information must flow faster than ever before. Even a short stoppage on a fast-moving production line can be very costly in terms of lost output. It is therefore essential that production problems be communicated quickly for corrective action to be taken. Another important element is the amount of information, which has greatly increased over the years, frequently causing an information overload. What is often needed is not more information but relevant information. It is necessary to determine what kind of information a manager needs to have for effective decision-making. Obtaining this information frequently requires getting information from managers' superiors and subordinates and also from departments and people elsewhere in the organization.

**LEADERSHIP PERSPECTIVE**

### Leading by Walking Around

www.ual.com
www.hp.com

Leadership demands information about what is really going on in the organization. Managers who never leave the office, and who rely on formal communication channels, may receive only the information that places subordinates in a favorable light. To overcome their isolation, managers need to supplement the formal communication channels with informal ones.

In their search for excellent companies, Thomas Peters and Robert Waterman noted that managers at United Airlines practice what has been labeled as "management by walking around."[1] A similar practice is called "management by wandering around" at Hewlett-Packard. The belief is that managers will improve informal communication channels by walking through the plant.



### The Manager's Need to Know

To be effective, a manager needs information necessary for carrying out managerial functions and activities. Yet even a casual glance at communication systems shows that managers often lack vital information for decision-making, or they may get too much information, resulting in overload. It is evident that managers must be discrimi-

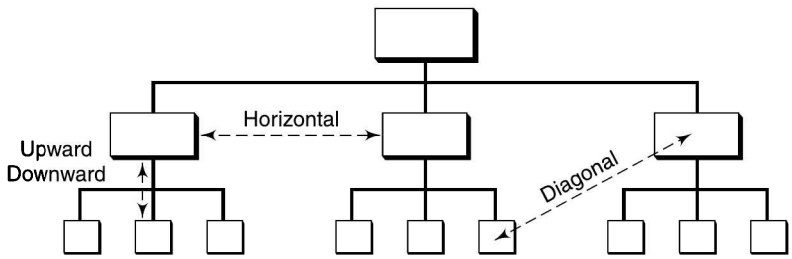
nating in selecting information. A simple way for a manager to start is to ask, "What do I really need to know for my job?" or "What would happen if I did not get this information on a regular basis?" It is not maximum information that a manager needs but pertinent information. Clearly, there is no universally applicable communication system; rather, a communication system must be tailored to the manager's needs.

## Communication Flow in the Organization

In an effective organization, communication flows in various directions: downward, upward, and crosswise. Traditionally, downward communication was emphasized, but there is ample evidence that problems will develop if communication flows only downward. In fact, one could argue that effective communication has to start with the subordinate, and this means primarily upward communication. Communication also flows horizontally and diagonally. The different kinds of information flows are diagramed in Figure 17.3 and elaborated below.

**Figure 17.3**

**Information Flow in an Organization.**




**Downward communication** flows from people at higher levels to those at lower levels in the organizational hierarchy.

### Downward communication

**Downward communication** flows from people at higher levels to those at lower levels in the organizational hierarchy. This kind of communication exists especially in organizations with an authoritarian atmosphere. The media used for oral downward communication include instructions, speeches, meetings, the telephone, loudspeakers, and even the grapevine. Examples of written downward communication are memorandums, letters, handbooks, pamphlets, policy statements, procedures, and electronic news displays.

Unfortunately, information is often lost or distorted as it comes down the chain of command. Top management's issuance of policies and procedures does not ensure communication. In fact, many directives are not understood or even read. Consequently, a feedback system is essential for finding out whether information was perceived as intended by the sender.

Downward flow of information through the different levels of the organization is time-consuming. Indeed, delays may be so frustrating that some top managers insist that information be sent directly to the person or group requiring it.

**Upward communication** travels from subordinates to superiors and continues up the organizational hierarchy.

## Upward communication

**Upward communication** travels from subordinates to superiors and continues up the organizational hierarchy. Unfortunately, this flow is often hindered by managers in the communication chain, who filter the messages and do not transmit all the information, especially unfavorable news, to their bosses. Yet, objective transmission of information is essential for control purposes. Upper management needs to know specifically production performance facts, marketing information, financial data, what lower-level employees are thinking, and so on.

Upward communication is primarily nondirective and is usually found in participative and democratic organizational environments. Typical means of upward communication, besides the chain of command, are suggestion systems, appeal and grievance procedures, complaint systems, counseling sessions, joint setting of objectives, the grapevine, group meetings, the practice of an open-door policy, morale questionnaires, exit interviews, and the ombudsperson.

**Ombudsperson** A person assigned to investigate employee concerns, thus providing a valuable upward communication link.

The concept of the **ombudsperson** was used relatively little in the United States until recently. It originated in Sweden, where a civil servant could be approached by a citizen to investigate complaints about the government bureaucracy. Now some U.S. companies have established a position for a person who investigates employees' concerns. Companies have found that the ombudsperson can provide a valuable upward communication link. Effective upward communication requires an environment in which subordinates feel free to communicate. Since the organizational climate is greatly influenced by upper management, the responsibility for creating a free flow of upward communication rests to a great extent, although not exclusively, with superiors.

**LEADERSHIP PERSPECTIVE**

### Lack of Upward Communication Can Be Disastrous

www.nasa.gov

www.bofa.com

http://en.wikipedia.org/wiki/E.F._Hutton_&_Co

The lack of upward communication can be disastrous. In the 1986 space shuttle disaster, vital information apparently did not reach the top management at the National Aeronautics and Space Administration (NASA) as discussed in Chapter 16. The Bank of America's top officials were surprised at the poor quality of their mortgage portfolio, which resulted in substantial losses for the bank. The brokerage house E. F. Hutton's executives were apparently unaware of the check-writing fraud of their lower-level managers.

In some organizations, upward communication is hindered by an organization culture and climate that "punishes" managers who communicate bad news or information with which top management does not agree. Indeed, the tendency to report only good news upward is quite common. Yet, correct information is absolutely necessary for managing an enterprise.

So what can managers do to facilitate the free flow of information? First, they must create an informal climate that encourages upward communication. An open-door policy is only useful when it is practiced. Second, the formal structure of information flow must be clear. Third, managers can learn a great deal by just wandering

through the corridors. Hewlett-Packard is often mentioned as an example of open communication because of the practice of management by wandering around.

**Horizontal flow** of information is among people on the same or similar organizational levels.

**Diagonal flow** of information is among persons at different levels who have no direct reporting relationships with one another.

**Crosswise communication** Crosswise communication includes the **horizontal flow** of information, among people on the same or similar organizational levels, and the **diagonal flow**, among persons at different levels who have no direct reporting relationships with one another. This kind of communication is used to speed information flow, to improve understanding, and to coordinate efforts for the achievement of organizational objectives. A great deal of communication does not follow the organizational hierarchy but cuts across the chain of command.

The enterprise environment provides many occasions for oral communication. They range from informal meetings of the company bowling team and lunch hours employees spend together to more formal conferences and committee and board meetings. This kind of communication also occurs when members of different departments form task teams or project groups. Finally, communication cuts across organizational boundaries when, for example, staff members with functional or advisory authority interact with line managers in different departments.

In addition, written forms of communication keep people informed about the enterprise. These written forms include the company newspaper or magazine and bulletin board notices. Modern enterprises use many kinds of oral and written crosswise communication patterns to supplement the vertical flow of information.

Since information flow may not follow the chain of command, proper safeguards need to be taken to prevent potential problems. Specifically, crosswise communication should rest on the understanding that crosswise relationships will be encouraged wherever they are appropriate, that subordinates will refrain from making commitments beyond their authority, and that subordinates will keep superiors informed of important interdepartmental activities. In short, crosswise communication may create difficulties, but it is a necessity in many enterprises in order to respond to the needs of the complex and dynamic organizational environment.

## Written, Oral, and Nonverbal Communication[2]

Written and oral communication media have favorable and unfavorable characteristics; consequently, they are often used together so that the favorable qualities of each can complement the limitations of the other. In addition, visual aids may be used to supplement both oral and written communications. A lecture in a management training session may be made more effective by the use of written handouts, transparencies, videotapes, and films. Evidence has shown that a message that is repeated through several media will be more accurately comprehended and recalled by the receiver.

In selecting the media, one must consider the communicator, the audience, and the situation. An executive who feels uncomfortable in front of a large audience may choose written communication rather than a speech. On the other hand, certain audiences who may not read a memo may be reached and become motivated by direct oral communication.

**Written communication** French managers are almost obsessed with the use of written communication, not only for formal messages but also for informal notes. A French manager stated that something has no reality unless it is written down.

Written communication has the advantage of providing records, references, and legal defenses. A message can be carefully prepared and then directed to a large audience through mass mailings. Written communication can also promote uniformity in policy and procedure and can reduce costs in some cases.

The disadvantages are that written messages may create mountains of paper, may be poorly expressed by ineffective writers, and may provide no immediate feedback. Consequently, it may take a long time to know whether a message has been received and properly understood.

**Oral communication** A great deal of information is communicated orally. Oral communication can occur in a face-to-face meeting of two people or in a manager's presentation to a large audience, it can be formal or informal, and it can be planned or accidental.

The principal advantage of oral communication is that it makes possible speedy interchange with immediate feedback. People can ask questions and clarify points. In a face-to-face interaction, the effect can be noted. Furthermore, a meeting with the superior may give the subordinate a feeling of importance. Clearly, informal or planned meetings can greatly contribute to the understanding of the issues.

However, oral communication also has disadvantages. It does not always save time, as any manager knows who has attended meetings in which no results or agreements were achieved. These meetings can be costly in terms of time and money.

LEADERSHIP PERSPECTIVE

## Can a Person Fearful of Public Speaking Become the Leader of a Large Publicly-Owned Corporation?[3]

Leaders are often required to speak to large groups of people. Consider Lee Scott, the CEO of Wal-Mart who hated that. He recalled that he was afraid speaking in meetings and stated: "I would shake and my voice would crack." Yet, in February 2005, he addressed 500 business leaders in Los Angeles, in just one of many public speeches in which he had to defend criticisms of Wal-Mart. They included providing insufficient health care benefits to its employees, substandard wages, requiring employees to work beyond their shifts, buying overseas thereby hurting U.S. companies, and putting local businesses out of business.

Students sometimes also encounter fear of addressing the class as part of the courser requirement. Could Mr. Scott's example serve as a role model in overcoming the fear of public speaking?



**Nonverbal communication** includes facial expressions and body gestures.

**Nonverbal communication** People communicate in many different ways. What a person says can be reinforced (or contradicted) by **nonverbal communication**,

such as facial expressions and body gestures. Nonverbal communication is expected to support the verbal, but it does not always do so. An autocratic manager may pound a fist on the table while announcing that from now on participative management will be practiced; such contradictory communications will certainly create a credibility gap. Similarly, managers may state that they have an open-door policy, but then they may have a secretary carefully screening people who want to see the managers. This creates incongruence between what managers say and what they do. This is an illustration of "noise" in the communication process model (Figure 17.2). Clearly, nonverbal communication may support or contradict verbal communication, giving rise to the saying that actions often speak louder than words.

### Communication Methods

There are different methods and channels for communication: some are oral, some are written, and some use information technology. They range from face-to-face communication, group meeting, and the various kinds of written communication discussed above. Technology is used for certain types of communication, such as the wired and wireless telephone, fax, voice mail, e-mail, as well as teleconference and videoconference. We highlighted above some of the advantages and disadvantages of various types of communication, including speed of feedback, ease of use, cost and time, as well as formality and informality. You probably do not want to invite an honored guest by e-mail. On the other hand, for informal communication, if time is of the essence and the technology is available, you may want to use e-mail rather than "snail mail" (regular mail).

Other communication topics are discussed in other parts of the book. For example, the grapevine, the informal and unofficial communication channel, was discussed in Chapter 10. The impact of technology on communication will be discussed in Chapter 19.

## BARRIERS AND BREAKDOWNS IN COMMUNICATION[4]

It is probably no surprise that managers frequently cite communication breakdowns as one of their most important problems. However, communication problems are often symptoms of more deeply rooted problems. For example, poor planning may be the cause of uncertainty about the direction of the firm. Similarly, a poorly designed organization structure may not clearly communicate organizational relationships. Vague performance standards may leave managers uncertain about what is expected of them. Thus, the perceptive manager will look for the causes of communication problems instead of just dealing with the symptoms. Barriers can exist in the sender, in the transmission of the message, in the receiver, or in the feedback. Specific communication barriers are discussed below.

### Lack of Planning

Good communication seldom happens by chance. Too often, people start talking and writing without first thinking, planning, and stating the purpose of the message.

Yet giving the reasons for a directive, selecting the most appropriate channel, and choosing proper timing can greatly improve understanding and reduce resistance to change.

## Unclarified Assumptions

Often overlooked, yet very important, are the uncommunicated assumptions that underlie messages. A customer may send a note stating that she will visit a vendor's plant. Then she may assume that the vendor will meet her at the airport, reserve a hotel room, arrange for transportation, and set up a full-scale review of the program at the plant. But the vendor may assume that the customer is coming to town mainly to attend a wedding and will make just a routine call at the plant. These unclarified assumptions in both instances may result in confusion and the loss of goodwill.

## Semantic Distortion

Another barrier to effective communication is semantic distortion, which can be deliberate or accidental. An advertisement that states "We sell for less" is deliberately ambiguous, begging the question: less than what? Words may evoke different responses. To some people, the word *government* may mean interference or deficit spending; to others, the same word may mean help, equalization, and justice.

## Poorly Expressed Messages

No matter how clear the idea is in the mind of the sender of communication, the message may still be marked by poorly chosen words, omissions, lack of coherence, poor organization, awkward sentence structure, platitudes, unnecessary jargon, and a failure to clarify its implications. This lack of clarity and precision, which can be costly, can be avoided through greater care in encoding the message.

## Communication Barriers in the International Environment[5]



www.exxon.com

Communication in the international environment is made more difficult because of different languages, cultures, and etiquette.[6] Translating advertising slogans is very risky. The slogan "Put a Tiger in Your Tank" by Exxon was very effective in the United States, yet it may be an insult to the people in Thailand. Colors have different meanings in different cultures. Black is often associated with death in many Western countries, while in the Far East white is the color of mourning. In business dealings, it is quite common in the United States to communicate on a first-name basis, yet in most other cultures, especially those with a pronounced hierarchical structure, people generally address one another by their surnames.

In the Chinese culture, words may not convey what people really mean because they may want to appear humble. For example, when a promotion is offered, the person may say that he or she is not qualified enough to assume great responsibility. But the expectation is that the superior will urge the subordinate to accept the promotion and will mention all the virtues and strengths of the candidate, as well as his or her suitability for the new position.

INTERNATIONAL PERSPECTIVE

## Country Differences in Explicit and Implicit Communication

Communication patterns differ between countries with respect to the degree to which they are explicit or implicit. In countries such as Germany and the United States, one expects that people mean what they say. The need for precision is illustrated in the popularity of management by objectives, where goals are stated precisely in quantitative, measurable terms whenever possible. In contrast, Japanese communication is implicit; the meaning has to be inferred. For example, Japanese dislike saying "no" in communication; instead, a negative answer is couched in ambivalent terms. This has been demonstrated many times in trade agreements between Japan and the United States, as well as between Japan and Europe.

While these observations may be, to some extent, an overgeneralization, managers who are aware of the different communication patterns still can benefit from this knowledge.

www.vw.com

To overcome communication barriers in the international environment, large corporations have taken a variety of steps. Volkswagen, for example, provides extensive language training. Furthermore, it maintains a large staff of translators. Frequently, local nationals, who know best the host country's language and culture, are hired for top positions. In the United States, foreign firms find it advantageous to hire students from their own country who are attending U.S. universities.

LEADERSHIP PERSPECTIVE

## Leaders in the Global Environment Need to be Multi-Lingual[7]

http://www.db.com/index_e.htm

How do executives spend their well deserved vacations? Some play golf, others learn to sail, and still others learn about Aristotle's ethics. Josef Ackermann, the Deutsche Bank's CEO, used a week's vacation studying Spanish six hours a day with a private tutor. He already knows English, Italian, French, and his native German. With the Deutsche Bank operating in many countries around the globe, Mr. Ackerman thinks that his multilingual skills help him to communicate with employees, customers, and government leaders around the world.

Many US executives rely on their English proficiencies in conducting business around the globe. And indeed, much of the business communication is in English, but the knowledge of other languages promotes business and personal relationships. Time is one of the most critical personal resource and some stressed executives combine leisure with continuing, never-ending education.

## Loss by Transmission and Poor Retention

In a series of transmissions from one person to the next, the message becomes less and less accurate. Poor retention of information is another serious problem. Thus, the necessity of repeating the message and using several channels is rather obvious. Consequently, companies often use more than one channel to communicate the same message.

## Poor Listening and Premature Evaluation

There are many talkers but few listeners. Everyone probably has observed people entering a discussion with comments that have no relation to the topic. One reason may be that these persons are pondering over their own problems—such as preserving their own egos or making a good impression on other group members—instead of listening to the conversation. Listening demands full attention and self-discipline. It also requires that the listener avoid premature evaluation of what another person has to say. A common tendency is to judge and to approve or disapprove what is being said, rather than trying to understand the speaker's frame of reference. Yet, listening without making hasty judgments can make the whole enterprise more effective and more efficient. For example, sympathetic listening can result in better labor–management relations and greater understanding among managers. Specifically, sales personnel may better understand the problems of production people, and the credit manager may realize that an overly restrictive credit policy may lead to a disproportionate loss in sales. In short, listening with empathy can reduce some of the daily frustrations in organized life and result in better communication.

## Impersonal Communication[8]

Effective communication is more than simply transmitting information to employees. It requires face-to-face contact in an environment of openness and trust. Improvement of communication often requires not expensive and sophisticated (and impersonal) communication media but the willingness of superiors to engage in face-to-face communication. Such informal gatherings, without status trappings or a formal authority base, may be threatening to a top executive, but the risks involved are outweighed by the benefits that better communication can bring.



## Distrust, Threat, and Fear

Distrust, threat, and fear undermine communication. In a climate containing these forces, any message will be viewed with skepticism. Distrust can be the result of inconsistent behavior by the superior, or it can be due to past experiences in which the subordinate was punished for honestly reporting unfavorable, but true, information to the boss. Similarly, in light of threats, whether real or imagined, people tend to tighten up, become defensive, and distort information. What is needed is a climate of trust, which facilitates open and honest communication.

## Insufficient Period for Adjustment to Change

The purpose of communication is to effect change that may seriously concern employees: shifts in the time, place, type, and order of work or shifts in group arrangements or skills to be used. Some communications point to the need for further training, career adjustment, or status arrangements. Changes affect people in different ways, and it may take time to think through the full meaning of a message. Consequently, for maximum efficiency, it is important not to force change before people can adjust to its implications.

## Information Overload

One might think that more and unrestricted information flow would help people overcome communication problems but unrestricted flow may result in too much information. People respond to information overload in various ways.[9] First, they may *disregard* certain information. A person getting too much mail may ignore letters that should be answered. Second, overwhelmed with too much information, people may *make errors* in processing it. For example, they may leave out the word "not" in a message, which reverses the intended meaning. Third, people may *delay* processing information, either permanently or with the intention of catching up in the future. Fourth, they may *filter* information. Filtering may be helpful when the most pressing and most important information is processed first and the less important messages receive lower priority. However, chances are that attention will be given first to matters that are easy to handle, while more difficult but perhaps critical messages are ignored. Finally, people respond to information overload by simply *escaping* from the task of communication. In other words, they ignore information or do not communicate it.

Some responses to information overload may be adaptive tactics that can, at times, be functional. For example, delaying the processing of information until the amount is reduced can be effective. On the other hand, withdrawing from the task of communicating is usually not a helpful response. Another way to approach the overload problem is to reduce the demand for information. Within an enterprise, this may be accomplished by insisting that only essential data be processed, such as information showing critical deviations from plans. Reducing external demand for information is usually more difficult because it is less controllable by managers. An example may be the government's demand for detailed documentation on governmental contracts. Companies that do business with the government simply have to comply with these requests.

## Other Communication Barriers

There are many other barriers to effective communication. In *selective perception*, people tend to perceive what they expect to perceive. In communication, this means that they hear what they want to hear and ignore other relevant information.

Closely related to perception is the influence of *attitude*, which is the predisposition to act or not to act in a certain way; it is a mental position regarding a fact or

state. Clearly, if people have made up their minds, they cannot objectively listen to what is said.

Still other barriers to communication are differences in *status* and *power* between the sender and the receiver of information. Also, when information has to pass through several organizational *levels*, it tends to be distorted.

## TOWARD EFFECTIVE COMMUNICATION[10]

The communication process model introduced earlier (Figure 17.2) helps to identify the critical elements in the communication process. At each stage, breakdowns can occur: in the encoding of the message by the sender, in the transmission of the message, and in the decoding and understanding of the message by the receiver. Certainly, "noise" can interfere with effective communication at each stage of the process.

### Guidelines for Improving Communication

Effective communication is the responsibility of all persons in the organization, managers as well as nonmanagers, in working toward a common aim. Whether communication is effective can be evaluated by the intended results. The following guidelines can help overcome the barriers to communication.

**1. Clarify the purpose of the message** Senders of messages must clarify in their minds what they want to communicate. This means that one of the first steps in communicating is to clarify the purpose of the message and to make a plan to achieve the intended end.

**2. Use intelligible encoding** Effective communication requires that encoding and decoding be done with symbols that are familiar to both the sender and the receiver of the message. Thus, the manager (and especially the staff specialist) should avoid unnecessary technical jargon, which is intelligible only to experts in their particular field.

**3. Consult others' views** The planning of the communication should not be done in a vacuum. Instead, other people should be consulted and encouraged to participate: to collect the facts, analyze the message, and select the appropriate media. For example, a manager may ask a colleague to read an important memo before it is distributed throughout the organization. The content of the message should fit the recipients' level of knowledge and the organizational climate.

**4. Consider receivers' needs** It is important to consider the needs of the receivers of the information. Whenever appropriate, one should communicate something that is of value to them, in the short run as well as in the more distant future. At times, unpopular actions that affect employees in the short run may be more easily accepted if they are beneficial to them in the long run. For instance, shortening the workweek may be more acceptable if it is made clear that this action

will strengthen the competitive position of the company in the long run and avoid layoffs.

**5. Use appropriate tone and language and ensure credibility** There is a saying that the tone makes the music. Similarly, in communication, the tone of voice, the choice of language, and the congruency between what is said and how it is said influence the reaction of the receiver of the message. An autocratic manager ordering subordinate supervisors to practice participative management will create a credibility gap that will be difficult to overcome.

**6. Get feedback** Too often, information is transmitted without communicating. Communication is complete only when the message is understood by the receiver. And the sender never knows whether the message is understood unless he or she gets feedback. This is accomplished by asking questions, requesting a reply to a letter, and encouraging receivers to give their reactions to the message.

**7. Consider receivers' emotions and motivations** The function of communication is more than transmitting information. It also deals with emotions, which are very important in interpersonal relationships between superiors, subordinates, and colleagues in an organization. Furthermore, communication is vital for creating an environment in which people are motivated to work toward the goals of the enterprise while they achieve their personal aims. Another function of communication is control. As explained in the discussion of Management by Objectives (MBO), control does not necessarily mean top-down control. Instead, the MBO philosophy emphasizes self-control, which demands clear communication with an understanding of the criteria against which performance is measured.

**8. Listen** Effective communicating is the responsibility not only of the sender but also of the receiver of the information. Thus, listening is an aspect that needs additional comment.

## Listening: A Key to Understanding

The rushed, never-listening manager will seldom get an objective view of the functioning of the organization. Time, empathy, and concentration on the communicator's message are prerequisites for understanding. People want to be heard, want to be taken seriously, and want to be understood. Thus, managers must avoid interrupting subordinates and putting them on the defensive. It is also wise both to give and to ask for feedback, for without it one can never be sure whether the message is understood. To elicit honest feedback, managers should develop an atmosphere of trust and confidence and a supportive leadership style, with a de-emphasis on status (such as barricading oneself behind an extrawide executive desk).

Listening is a skill that can be developed through appropriate techniques.

Listening is a skill that can be developed. John W. Newstrom and Keith Davis propose ten techniques for improving listening: (1) stop talking, (2) put the talker at ease, (3) show the talker that you want to listen, (4) remove distractions, (5) empathize with the talker, (6) be patient, (7) hold your temper, (8) go easy on

arguments and criticism, (9) ask questions, and (10) stop talking! The first and the last points are the most important: people have to stop talking before they can listen.[11]

## Tips for Improving Written Communication

Effective writing may be an exception rather than the rule; nor do education and intelligence guarantee good writing. Many people fall into the habit of using technical jargon that can be understood only by experts in the same field. Common problems in written communication are that writers omit the conclusion or bury it in the report, are too wordy, and use poor grammar, inappropriate words, ineffective sentence structure, and incorrect spelling. Yet, a few guidelines may do much to improve written communication:[12]

- Use simple words and phrases
- Use short and familiar words
- Use personal pronouns (such as "you") whenever appropriate
- Give illustrations and examples; use charts
- Use short sentences and paragraphs
- Use active verbs, such as "The manager *plans* . . . "
- Avoid unnecessary words

John Fielden suggests that the writing style should fit the situation and the effect the writer wants to achieve.[13] Specifically, he recommends a *forceful* style when the writer has power, using a polite but firm tone. The *passive* style is appropriate when the writer is in a position lower than that of the recipient of the message. The *personal* style is recommended for communicating good news and making persuasive requests for action. The *impersonal* style is generally right for conveying negative information. The *lively* or *colorful* style is suitable for good news, advertisements, and sales letters. On the other hand, a less colorful style, combining the impersonal with the passive, may be appropriate for common business writing.

## Tips for Improving Oral Communication

For some people, including executives, the thought of having to give a speech may cause nightmares. Yet, giving speeches and having fun doing it can be learned. A classic example of how one can learn oral communication is the Greek statesman Demosthenes, who, after being very discouraged following his poorly delivered first public speech, became one of the greatest orators through practice, practice, and practice.

Managers need to inspire, to lead, to communicate a vision. A clear idea of the organizational purpose is essential but insufficient for leading. This vision must be articulated. This means not only to state the facts but also to deliver them in a way that inspires people by catering to their values, their pride, and their personal objectives.

Most of the tips for written communication also apply to oral communication. The following Perspective provides helpful hints for improving oral communication.

LEADERSHIP PERSPECTIVE

### Learning from Newscasters[14]

Some of the most effective communicators are American television news anchors, such as NBC's Tom Brokaw, ABC's Peter Jennings, and CBS's Dan Rather. How do they keep the television audience's attention despite the many attractive programs on other channels? Here are some hints you may use:

- Communicate with a large audience as you would do in a one-to-one conversation
- Tell a story, an anecdote, and give examples
- Pause—do not rush. In a discussion, a pause shows that you are listening
- Use visual aids, such as diagrams, charts, overhead slides, and computer graphic presentations
- Communicate confidence and create trust. This can be done by a strong and clear voice, good posture, and a smile
- Use a colorful, specific language and show through your body language that you are confident and are in command of the situation

The next time you watch television; think what you can learn from the highly paid news anchors, who reach sometimes millions of people.

## ELECTRONIC MEDIA IN COMMUNICATION[15]

Organizations are increasingly adopting various electronic devices that improve communication. Electronic equipment includes mainframe computers, minicomputers, personal computers, and e-mail systems, as well as cell phones for making calls while on the move and beepers for keeping in contact with the office. The impact of computers on all phases of the management process will be discussed in Chapter 19 in connection with management information systems and will therefore be mentioned only briefly here. Let us first look at telecommunication in general and at the increasing use of teleconferencing in particular.

### Telecommunication

Telecommunication is now widely used. Many organizations have already effectively used the new technology in a variety of ways, as shown by the following examples:

- Some banks supply hardware and software to their corporate customers so that they can easily transfer funds to their suppliers.
- Several banks now make phone banking services available, even to individuals.
- Information can be transmitted within seconds or minutes to countries on the opposite side of the globe by fax or e-mail.

- Car makers stay in close contact with their suppliers through telecommunication means to inform them about their needs, thus permitting just-in-time delivery and reducing inventory costs.
- Computerized airline reservation systems facilitate flight booking.
- Many firms now have detailed personnel information, including performance appraisals and career development plans, in a data bank.

As you can see, there are many applications of telecommunication. But to make telecommunication systems effective, technical experts must make every effort to identify the real needs of organizations and their customers and to design systems that are useful and user-friendly. Let us now turn to a specific application of the new technology: teleconferencing.

## Teleconferencing

**Teleconference** A group of people interacting with each other by means of audio and video media with moving or still pictures.

Owing to the wide variety of systems, including audio systems, audio systems with snapshots displayed on a video monitor, and live video systems, the term *teleconferencing* is difficult to define. In general, most people think of a **teleconference** as a group of people interacting with each other by means of audio and video media with moving or still pictures.

Full-motion video is frequently used to hold meetings among managers. Not only do they hear each other but they can also see each other's expressions as well as visual displays. This kind of communication is of course rather expensive, and audio in combination with still video may be used instead. This method of communicating may be useful for showing charts or illustrations during a technical discussion.

Some of the potential advantages of teleconferencing include savings in travel expenses and travel time. Also, conferences can be held whenever necessary, since there is no need to make travel plans long in advance. Because meetings can be held more frequently, communication is improved between, for example, headquarters and geographically scattered divisions.

There are also drawbacks to teleconferencing. Due to the ease in arranging meetings in this manner, they may be held more often than necessary. Moreover, since this approach uses rather new technology, the equipment is more prone to breakdowns. Most important, perhaps, teleconferencing is still a poor substitute for face-to-face meetings. Despite these limitations, increased use of teleconferencing is likely in the future.



## The Use of Computers for Information Handling and Networking

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Electronic Data Processing (EDP) now makes it possible to handle large amounts of data and to make information available to a large number of people. Thus, one can obtain, analyze, and organize timely data quite inexpensively. However, it must never be forgotten that data is not necessarily information—information must inform someone. New computer graphics can inform visually, displaying important company information in a matter of seconds. At PepsiCo Inc., managers used to dig through

reams of computer printouts for information; now they can quickly display a colored map showing their competitive picture.

**Instant messaging** shows whether a friend or colleague is connected to the Internet; if connected, messages can be exchanged instantly.

www.aol.com
www.attbi.com
www.earthlink.com
www.msn.com

The new information technology fundamentally changes communication.[16] Fax, e-mail, and instant messaging are replacing traditional communication channels, such as the postal mail. **Instant messaging** shows whether a friend or colleague is connected to the Internet; if connected, messages can be exchanged instantly. Internet access providers such as America Online, AT&T, Earthlink, and MSN provide systems through which mail can be sent electronically with speed and at a low cost. Information technology makes the global organization possible and enables companies to respond faster to global changes.

During the early application of computers, specialists, professionals, and managers were the dominant users of the computing infrastructure; now employees in nonmanagerial positions often have access to the same information as top managers. There is also a shift from personal to work group computing and from internal to interorganizational computing by connecting with people and organizations outside the company, such as banks, governments, distributors, customers, and suppliers. For example, outsourcing is facilitated by faster and better communication, which also aids coordination and cooperation.

The computer is expanding its role from simply managing information to communication. Networking can open channels of communication that never existed before and can become a tool for the learning organization. The Internet, for example, facilitates networking of human intelligence. But the new age of information technology brings with it a host of new problems, such as privacy invasion,[17] security breaches, and even threats to freedom. There will be more about the impact of the computer and networking in Chapter 19.

## SUMMARY

Communication is important for the internal functioning of the organization and for interaction with the external environment. Communication is the transfer of information from a sender to a receiver, with the information being understood by the receiver. The communication process begins with the sender, who encodes an idea that is sent in oral, written, visual, or some other form to the receiver. The receiver decodes the message and gains an understanding of what the sender wants to communicate. This in turn may result in some change or action. But the communication process may be interrupted by "noise," which is anything that hinders communication.

In an organization, managers should have the information necessary for doing a good job. The information may flow not only downward or upward in the organization structure but also horizontally or diagonally. Communication can be in written form, but more information is communicated orally. In addition, people communicate through gestures and facial expressions. A great variety of communication methods are available. For example, technology may be used for wired and wireless telephone, fax, voice, and email as well as teleconferences and video conferences.

Communication is hindered by barriers and breakdowns in the communication process. Recognizing these barriers and listening facilitate not only understanding but also managing. Tips for improving written and oral communication are suggested. Electronic media can improve communication, as illustrated by teleconferencing and the application of computers, two of many ap-

proaches to handling the increasing amount of information in organizations and coping with the trend of globalization.

## KEY IDEAS AND CONCEPTS FOR REVIEW

- ✔ Communication
- ✔ Communication Process Model
- ✔ "Noise" in communication
- ✔ Downward communication
- ✔ Upward communication
- ✔ Ombudsperson
- ✔ Crosswise communication
- ✔ Written communication: advantages and disadvantages
- ✔ Oral communication: advantages and disadvantages
- ✔ Nonverbal communication
- ✔ Barriers and breakdowns in communication
- ✔ Responses to information overload
- ✔ Guidelines for improving communication
- ✔ Listening as a key to understanding
- ✔ Teleconferencing
- ✔ Instant messaging

## FOR DISCUSSION

1. Briefly describe the communication process model. Select a communication problem and determine the cause (or causes) by applying the model in your analysis.
2. List different channels for transmitting a message. Discuss the advantages and disadvantages of the various channels.
3. What are some kinds of downward communication? Discuss those used most frequently in an enterprise you are familiar with. How effective are the various types?
4. What are some problems in upward communication? What would you suggest for overcoming the difficulties?
5. What are the advantages and disadvantages of written and oral communication? Which do you prefer: written or oral? Under what circumstances?
6. What is information overload? Do you ever experience it? How do you deal with it?
7. How well do you listen? How could you improve your listening skills?
8. Discuss the role of electronic media in communication.



## EXERCISES/ACTION STEPS

1. Recall a situation that occurred at home or at work and identify the communication problems that you observed or experienced. Discuss how the communication model in this chapter can help you locate the problems.

2. Go to the library and do research on a public figure who communicates well. Discuss this person's characteristics as they relate to communication.

## INTERNET RESEARCH

1. Search the Internet for the term "Electronic Data Processing" or "EDP". Find out the definition of the term and see how it evolved through the history of business communication.
2. Use a search engine to find out about various forms of wireless or mobile communications. How can each type of wireless device enhance your business communication capability?

**Leadership Case**

## Transformational Communication by American Presidents[18]

Communication is not only important in organizations, but may have dramatic effects in politics as illustrated by transformational rhetoric by U.S. presidents. Leadership means influencing people. This may be achieved by behavior, but also by rhetoric. Leaders are often remembered by important speeches. The most memorable one is by the U.S. President John F. Kennedy in his inaugural address when he said: "And so, my fellow Americans: ask not what your country can do for you – ask what you can do for your country. My fellow citizens of the world: Ask not what America will do for you, but what together we can for the freedom of man." This speech may have inspired the founding of the Peace Corps, a volunteer program with the goals of providing technical assistance to other countries, understanding the cultures of other countries, and helping other countries to understand U.S. culture.

Another speech by President Ronald Reagan at the Brandenburg Gate in Berlin may have influenced the eventual downfall of the Berlin wall and the unification of east and west Germany. Reagan said: "General Secretary Gorbachev, if you seek peace, if you seek prosperity for the Soviet Union and Eastern Europe, if you seek liberalization: Come here to this gate! Mr. Gorbachev, open this gate! Mr. Gorbachev, tear down this wall!"

**Questions**

1. Do you think that the speeches by Kennedy and Regan influenced history?
2. Identify political or business leaders who influenced the direction of the company or country. What did they say? In what context did they say it? How effective was their communication?
3. How do you feel about giving a speech on a management topic in your class?

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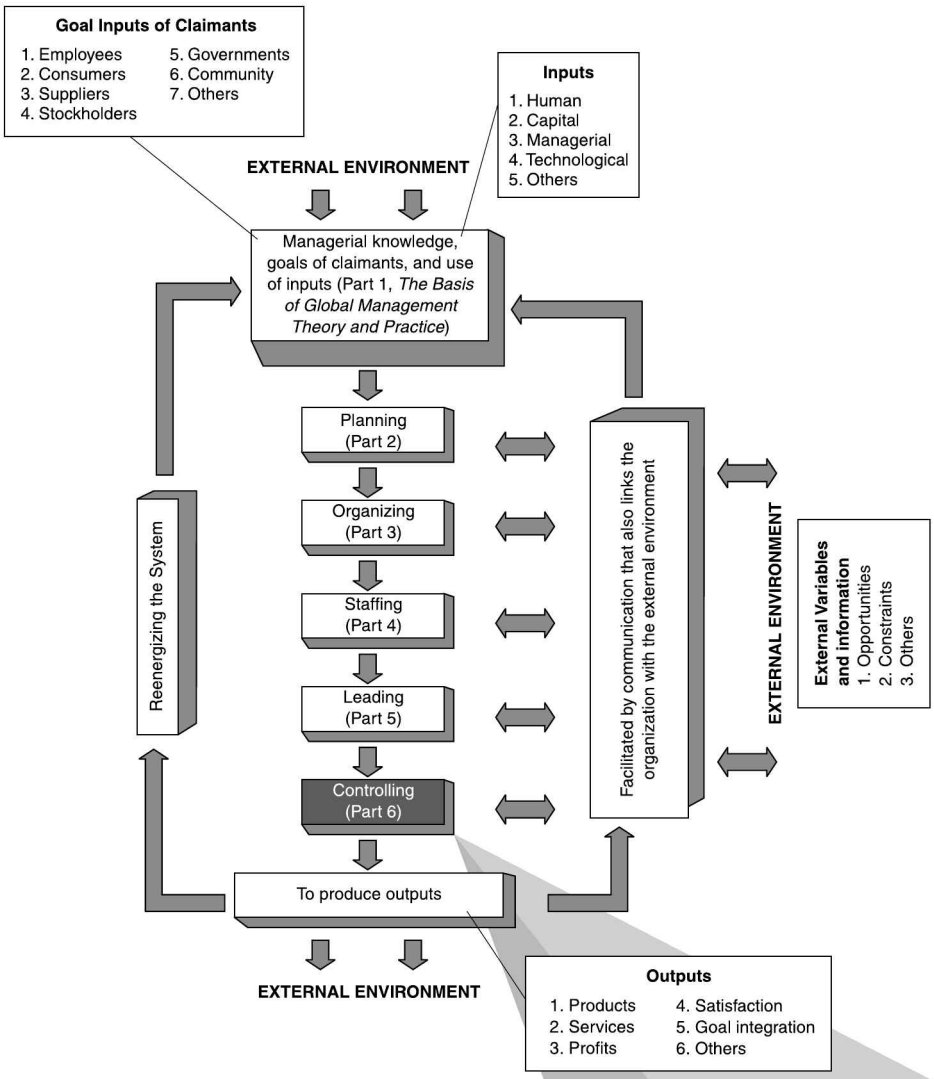


## SYSTEMS APPROACH TO MANAGEMENT: CONTROLLING

Part 6

18. The System and Process of Controlling
19. Control Techniques and Information Technology
20. Productivity, Operations Management, and Total Quality Management

# 18 The System and Process of Controlling

## CHAPTER OBJECTIVES

After studying this chapter, you should be able to:

- Describe the steps in the basic control process
- Enumerate and explain the critical control points, standards, and benchmarking
- Illustrate applications of the feedback system
- Understand that real-time information will not solve all the problems of management control
- Show that feedforward control systems can make management control more effective
- Describe some of the most widely used techniques of overall control of an enterprise
- Recognize the use and problems of management audits by accounting firms
- Understand the difference between bureaucratic and clan control
- List and explain the requirements for effective controls

**Controlling** The measurement and correction of performance in order to make sure that enterprise objectives and the plans devised to attain them are being accomplished.

While leaders provide a vision for the organization and their followers, they also need to implement that vision. This means that performance needs to adhere to plans, which requires controlling. The managerial function of **controlling** is the measurement and correction of performance in order to make sure that enterprise objectives and the plans devised to attain them are being accomplished. Planning and controlling are closely related. In fact, some writers on management think that these functions cannot be separated. It is wise to separate them conceptually, however, which is why they are discussed individually in Parts 2 and 6 of this book. Still, planning and controlling may be viewed as the blades of a pair of scissors: the scissors cannot work unless there are two blades. Without objectives and plans, control is not possible because performance has to be measured against some established criteria.

## THE BASIC CONTROL PROCESS

Control techniques and systems are essentially the same for controlling cash, office procedures, morale, product quality, and anything else. The basic control process, wherever it is found and whatever is being controlled, involves three steps: (1) establishing standards, (2) measuring performance against these standards, and (3) correcting variations from standards and plans.

## Establishment of Standards

**Standards** Criteria of performance.

Because plans are the yardsticks against which managers devise controls, the first step in the control process logically would be to establish plans. However, since plans vary in detail and complexity, and since managers cannot usually watch everything, special standards are established. **Standards** are simply criteria of performance. They are the selected points in an entire planning program at which measures of performance are made so that managers can receive signals about how things are going and thus do not have to watch every step in the execution of plans.

There are many kinds of standards. Among the best are verifiable goals or objectives, as suggested in the discussion of managing by objectives (see Chapter 4). You will learn more about standards later, especially those that point out deviations at critical points.

## Measurement of Performance

Although such measurement is not always practicable, the measurement of performance against standards should ideally be done on a forward-looking basis so that deviations may be detected in advance of their occurrence and avoided by appropriate actions. The alert, forward-looking manager can sometimes predict probable departures from standards. In the absence of such ability, however, deviations should be disclosed as early as possible.

## Correction of Deviations

Standards should reflect the various positions in an organization structure. If performance is measured accordingly, it is easier to correct deviations. Managers know exactly where, in the assignment of individual or group duties, the corrective measures must be applied.

Correction of deviations is the point at which control can be seen as a part of the whole system of management and can be related to the other managerial functions. Managers may correct deviations by redrawing their plans or by modifying their goals. (This is an exercise of the principle of navigational change.) Or they may correct deviations by exercising their organizing function through reassignment or clarification of duties. They may correct, also, by additional staffing, by better selection and training of subordinates, or by that ultimate restaffing measure—firing. Another way is to correct through better leading—fuller explanation of the job or more effective leadership techniques.

**INTERNATIONAL PERSPECTIVE**

## Special Considerations in Controlling International Companies

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Controlling domestic companies is often difficult, let alone exercising control of operations in different countries. The geographic distances make certain controls, such

as observation, very difficult, despite modern jet service. Wal-Mart, for example, has operations around the globe. The same measurement criteria can hardly be applied to all stores.

Control standards have to be adjusted to the local environment. Subsidiaries in low labor-cost countries may have lower cost budgets than those in countries with a high-cost labor force. And productivity in countries with low labor costs may lag behind that of other countries.

Transfer pricing between the headquarters and the subsidiaries or between subsidiaries may distort the profitability and return-on-investment pictures. A similar distortion can occur through currency fluctuations among the various countries. Moreover, erratic or chronic inflation makes the setting of standards and measurement against those standards difficult.

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Other factors should also be considered in controlling. As pointed out in the discussion of organizing, the organization structure should facilitate control. Multinational corporations require a different departmentation from that of domestic firms. Another way to exercise control is to prevent deviations from occurring by selecting competent managers. In the past, multinational corporations sent experienced managers to head their foreign subsidiaries. More recently, however, companies have been selecting and training local managers from the country in which they operate. Furthermore, managers with special skills in cultural adaptation may even come from a third country. At one time, the chief executive officer (CEO) of Volkswagen in America was neither a German nor an American but a Canadian.

The way control is exercised differs between countries. In the United States, attempts are made to pinpoint responsibility for deviations from standards. In many Asian countries, superiors usually try not to let the person responsible lose face. Moreover, standards may not even be set in measurable terms in the first place. How, then, can control be exercised? In countries such as Japan where group work is common, peer pressure may be a very effective means for exercising control.

In short, controlling—setting standards, measuring performance, and taking corrective actions—must be flexible enough to take into account the organizational and country-specific environment.

## CRITICAL CONTROL POINTS, STANDARDS, AND BENCHMARKING

**Principle of critical point control** Effective control requires attention to factors critical to evaluating performance against plans.

Standards are yardsticks against which actual or expected performance is measured. In a simple operation, a manager might control through careful personal observation of the work being done. However, in most operations, this is not possible because of the complexity of the operations and the fact that a manager has far more to do than personally observe performance for a whole day. A manager must choose points for special attention and then watch them to be sure that the whole operation is proceeding as planned.

The points selected for control should be *critical*, in the sense either of being limiting factors in the operation or of being better indicators than other factors of whether plans are working out. With such standards, managers can handle a larger

group of subordinates and thereby increase their span of management, with resulting cost savings and improvement of communication. The **principle of critical point control**, one of the more important control principles, states that effective control requires attention to those factors critical to evaluating performance against plans. Another way of controlling is comparing company performance with that of other firms through benchmarking.

## Types of Critical Point Standards

Every objective, every goal of the many planning programs, every activity of these programs, every policy, every procedure, and every budget can become a standard against which actual or expected performance might be measured. In practice, however, standards tend to be of the following types: (1) physical standards, (2) cost standards, (3) capital standards, (4) revenue standards, (5) program standards, (6) intangible standards, (7) goals as standards, and (8) strategic plans as control points for strategic control.

**Physical standards** Physical standards are nonmonetary measurements and are common at the operating level, where materials are used, labor is employed, services are rendered, and goods are produced. They may reflect quantities, such as labor-hours per unit of output, pounds of fuel per horsepower per hour, ton-miles of freight traffic carried, units of production per machine-hour, or feet of wire per ton of copper. Physical standards may also reflect quality, such as hardness of bearings, closeness of tolerances, rate of climb of an airplane, durability of a fabric, or fastness of a color.

**Cost standards** Cost standards are monetary measurements and, like physical standards, are common at the operating level. They attach monetary values to specific aspects of operations. Illustrative of cost standards are such widely used measures as direct and indirect costs per unit produced, labor cost per unit or per hour, material cost per unit, machine-hour costs, cost per seat-mile, selling cost per dollar or unit of sales, and cost per foot of oil well drilled.

**Capital standards** There are a variety of capital standards, all arising from the application of monetary measurements to physical items. They have to do with the capital invested in the firm rather than with operating costs and are therefore primarily related to the balance sheet rather than to the income statement. Perhaps the most widely used standard for new investment, as well as for overall control, is return on investment. The typical balance sheet will disclose other capital standards, such as the ratios of current assets to current liabilities, debt to net worth, fixed investment to total investment, cash and receivables to payables, and bonds to stocks, as well as the size and turnover of inventories.

**Revenue standards** Revenue standards arise from attaching monetary values to sales. They may include such standards as revenue per bus passenger-mile, average sales per customer, and sales per capita in a given market area.

**Program standards** A manager may be assigned to install a variable budget program, a program for formally following the development of new products, or a program for improving the quality of a sales force. Although some subjective judgment may have to be applied in appraising program performance, timing and other factors can be used as objective standards.

**Intangible standards** More difficult to set are standards not expressed in either physical or monetary measurements. What standard can a manager use for determining the competence of the divisional purchasing agent or the personnel director? What can one use for determining whether the advertising program meets both short- and long-term objectives? Or whether the public relations program is successful? Are supervisors loyal to the company's objectives? Such questions show the difficulty of establishing standards or goals for clear quantitative or qualitative measurement.

**Goals as standards** With the present tendency for better-managed enterprises to establish an entire network of verifiable qualitative or quantitative goals at every level of management, the use of intangible standards, while still important, is diminishing. In complex program operations, as well as in the performance of managers themselves, modern managers are finding that through research and thinking, it is possible to define goals that can be used as performance standards. While the quantitative goals are likely to take the form of the standards outlined above, the definition of qualitative goals represents an important development in the area of standards. For example, if the program of a district sales office is spelled out to include such elements as training salespeople in accordance with a plan with specific characteristics, the plan and its characteristics themselves furnish standards that tend to become objective and therefore "tangible."

**Strategic control** Systematic monitoring at strategic control points and modifying the organization's strategy based on this evaluation.

**Strategic plans as control points for strategic control** **Strategic control** requires systematic monitoring at strategic control points and modifying the organization's strategy based on this evaluation. As pointed out earlier, planning and controlling are closely related. Therefore, strategic plans require strategic control. Moreover, since control facilitates comparison of intended goals with actual performance, it also provides opportunities for learning, which in turn is the basis for organizational change. Finally, through the use of strategic control, one gains insights not only about organizational performance but also about the ever-changing environment by monitoring it.

## Benchmarking[1]

**Benchmarking** An approach for setting goals and productivity measures based on best industry practices.

**Benchmarking** is a concept that is now widely accepted. It is an approach for setting goals and productivity measures based on best industry practices. Benchmarking developed out of the need to have data against which performance can be measured. What should the criteria be? If a company needs six days to fill a customer's order and the competitor in the same industry needs only five days, five days does not become the standard if a firm in an unrelated industry can fill orders in four days.

The four-day criterion becomes the benchmark even when at first this seems to be an unachievable goal. The process involved in filling the order is then carefully analyzed, and creative ways are encouraged to achieve the benchmark.

Three types of benchmarking: strategic, operational, and management.

There are three types of benchmarking. First, *strategic benchmarking* compares various strategies and identifies the key strategic elements of success. Second, *operational benchmarking* compares relative costs or possibilities for product differentiation. Third, *management benchmarking* focuses on support functions such as market planning and information systems, logistics, human resource management, and so on.

The benchmarking procedure begins with the identification of what is to be benchmarked. Then superior performers have to be selected. Data need to be gathered and analyzed, which become the basis for performance goals. During the implementation of the new approach, performance is periodically measured and corrective actions are taken at that time.

## CONTROL AS A FEEDBACK SYSTEM

Managerial control is essentially the same basic control process as that found in physical, biological, and social systems. Many systems control themselves through information feedback, which shows deviations from standards and initiates changes. In other words, systems use some of their energy to feed back information that compares performance with a standard and initiates corrective action. A simple feedback system was shown in Figure 4.1 in Chapter 4.

**INTERNATIONAL PERSPECTIVE**

### Examples of Feedback Systems

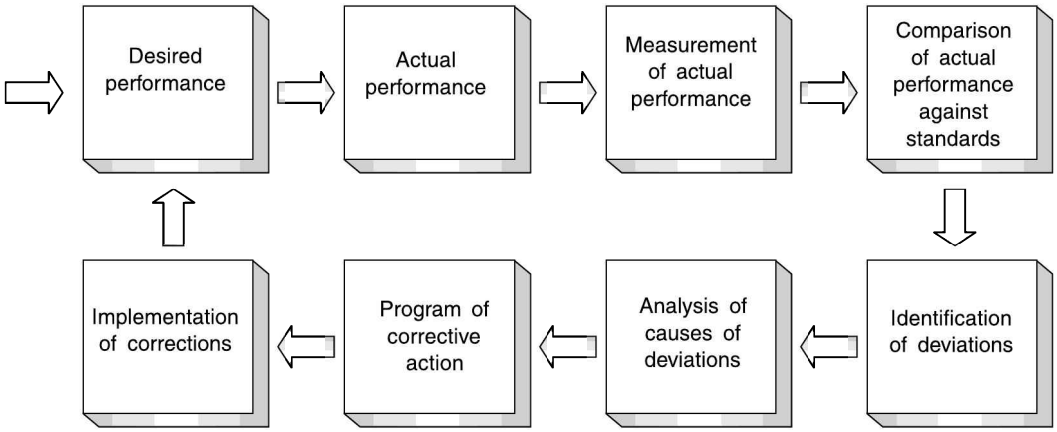
The house thermostat is a system of feedback and information control. When the house temperature falls below the preset level, an electric message is sent to the heating system, which is then activated. When the temperature rises and reaches the set level, another message shuts off the heater. This continual measurement and turning on and off of the heater keeps the house at the desired temperature. A similar process activates the air-conditioning system. As soon as the temperature exceeds the preset level, the air-conditioning system cools the house to the desired temperature. Likewise, in the human body, a number of feedback systems control temperature, blood pressure, motor reactions, and other conditions. Another example of feedback is the grade a student receives on a midterm test. This is intended, of course, to give the student information about how he or she is doing and, if performance is less than desirable, to send a signal suggesting improvement.

Management control is usually perceived as a feedback system similar to the common household thermostat.

Management control is usually perceived as a feedback system similar to that which operates in the common household thermostat. This can be seen clearly in Figure 18.1, which shows the feedback process in management control. This system places control in a more complex and realistic light than if it is regarded merely as

**Figure 18.1**

**Feedback Loop of Management Control.**




a matter of establishing standards, measuring performance, and correcting for deviations. Managers do measure actual performance, compare this measurement against standards, and identify and analyze deviations. But then, to make the necessary corrections, they must develop a program for corrective action and implement this program in order to arrive at the performance desired.

## REAL-TIME INFORMATION AND CONTROL

**Real-time information** Information about what is happening while it is happening.

One of the interesting advances arising from the use of the computer and from electronic gathering, transmission, and storage of data is the development of systems of **real-time information**. This is information about what is happening while it is happening. It is technically possible through various means to obtain real-time data on many operations. For years, airlines have obtained information about seat availability simply by entering a flight number, trip segment (e.g., London to New York), and date into a memory system, which immediately responds with the information. Supermarkets and department stores have electronic cash registers in operation that immediately transmit data on every sale to a central data storage facility, where inventory, sales, gross, profit, and other data can be obtained as sales occur. A factory manager can have a system that reports at any time the status of a production program in terms of such things as the production point reached, labor-hours accumulated, and even whether the project is late or on time in the manufacturing process.

Some people see real-time information as a means of getting real-time control in areas of importance to managers—in other words, control effected at the very time information shows a deviation from plans. But reference to the management control feedback loop in Figure 18.1 shows that real-time information does not, except possibly in the simplest and most unusual cases, make possible real-time control. It is possible in many areas to collect real-time data that measure performance. It may

also be possible in many of these cases to compare these data with standards and even to identify deviations. But the analysis of causes of deviations, the development of programs of correction, and the implementation of these programs are likely to be time-consuming tasks.

In the case of quality control, for example, it may take considerable time to discover what is causing factory rejects and more time to put corrective measures into effect. In the more complex case of inventory control, particularly in a manufacturing company, which has many items—raw materials, component parts, goods in process, and finished goods—the correction time may be very long. Once it is learned that an inventory is too high, the steps involved in getting it back to the desired level may take a number of months. And so it goes with most other instances of management control problems: time lags are unavoidable.

This does not mean that prompt measurement of performance is unimportant. The sooner managers know that activities for which they are responsible are not proceeding in accordance with plans, the faster they can take action to make corrections. Even so, there is always the question of whether the cost of gathering real-time data is worth the few days saved. Often it is, as in the case of the airline business, in which ready information on seat availability is likely to be crucial to serving customers and filling airplanes. But in a major defense company producing one of the highest-priority defense equipment items, there was little real-time information in an otherwise highly sophisticated information control system. Even for this program, it was thought that the benefit of gathering real-time data was not worth the expense because the correction process took so long.

## FEEDFORWARD OR PREVENTIVE CONTROL

The time lag in the management control process shows that control must be directed toward the future if it is to be effective. It illustrates the problem of only using feedback from the output of a system and measuring this output as a means of control. It shows the deficiency of historical data, such as those received from accounting reports. One of the difficulties with such historical data is that they tell business managers in November that they lost money in October (or even September) because of something that was done in July. At this late time, such information is only a distressingly interesting historical fact.

Managers need, for effective control, a system that will inform them potential of problems while giving them time to take corrective action before those problems occur.

What managers need, for effective control, is a system that will tell them, in time to take corrective action, that certain problems will occur if they do not do something now. Feedback from the output of a system is not good enough for control. It is little more than a postmortem, and no one has found a way to change the past.

Future-directed control is largely disregarded in practice, mainly because managers have been so dependent for purposes of control on accounting and statistical data. To be sure, in the absence of any means of looking forward, reference to history—on the questionable assumption that what is past is prologue—is admittedly better than no reference at all.

## Feedforward in Human Systems

There are many examples of feedforward control in human systems. A motorist, for example, who wishes to maintain a constant speed in going up a hill, would not usually wait for the speedometer to signal a drop in speed before depressing the accelerator. Instead, knowing that the hill represents a disturbing variable in the system, the driver would probably correct for this by pressing the accelerator before speed falls. Likewise, a hunter will always aim ahead of a duck's flight to correct for the time lag between a shot and a hoped-for hit.

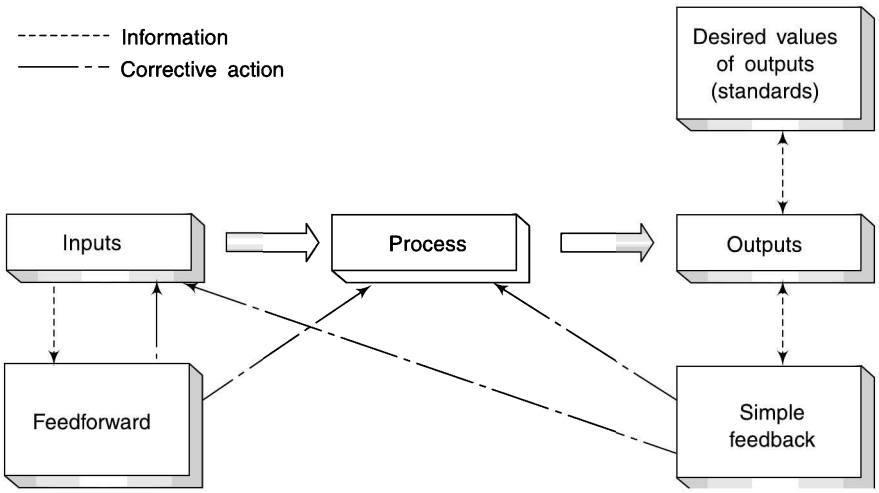
## Feedforward versus Feedback Systems

**Feedforward systems** monitor inputs into a process to ascertain if the inputs are as planned; if they are not, the inputs or the process is changed in order to obtain the desired results.

Simple feedback systems measure outputs of a process and feed into the system or the inputs of the system corrective actions to obtain desired outputs. For most management problems, because of time lags in the correction process, this is not good enough. Feedforward systems monitor *inputs* into a process to ascertain whether the inputs are as planned; if they are not, the inputs, or perhaps the process, are changed in order to obtain the desired results. A comparison of feedforward and feedback systems is depicted in Figure 18.2.

**Figure 18.1**

**Comparison of Simple Feedback and Feedforward Systems.**




In a sense, a feedforward control system is really a kind of feedback system. However, the information feedback is at the *input* side of the system so that corrections can be made before the system output is affected. Also, even with a feedforward system, a manager would still want to measure the final system output, since nothing can be expected to work perfectly enough to ensure that the final output will always be exactly as desired.

## Feedforward in Management*

An idea of what feedforward means in management control can be conveyed through the example of inventory planning system. Figure 18.3 illustrates what is involved. The somewhat simplified schematic figure of input variables for inventory planning and control indicates that, if managers are to exercise effective control over inventory, they must identify the variables in the system. Some of the variables have either a negative or a positive effect on inventory.

Also, if the system of variables and their impact on a process are accurately portrayed—and each enterprise should design its own system, appropriate to the realities of its situation—a deviation from any planned input can result in an unplanned output, unless something is done about it in time. For example, in the case of the inventory model, if delivered purchases are greater than planned or if factory usage turns out to be less than planned, the result will be a higher-than-planned inventory, unless corrective action is taken. Of course, to make feedforward work in practice, inputs must be carefully monitored.

One of the problems in all feedforward control systems is the necessity of watching for what engineers call disturbances. These are factors which have not been taken into account in the input model but which may have an impact on the system and the desired end result. Obviously, it would be impracticable to take into account in a model all inputs that might possibly affect the operation of a program. For example, the bankruptcy of a large supplier might be an unanticipated, and unprogrammed, input variable and would delay the shipping of supplies. Since unprogrammed events do sometimes occur and may upset a desired output, monitoring regular inputs must be supplemented by watching for, and taking into account, unusual and unexpected disturbances.

## Requirements for Feedforward Control

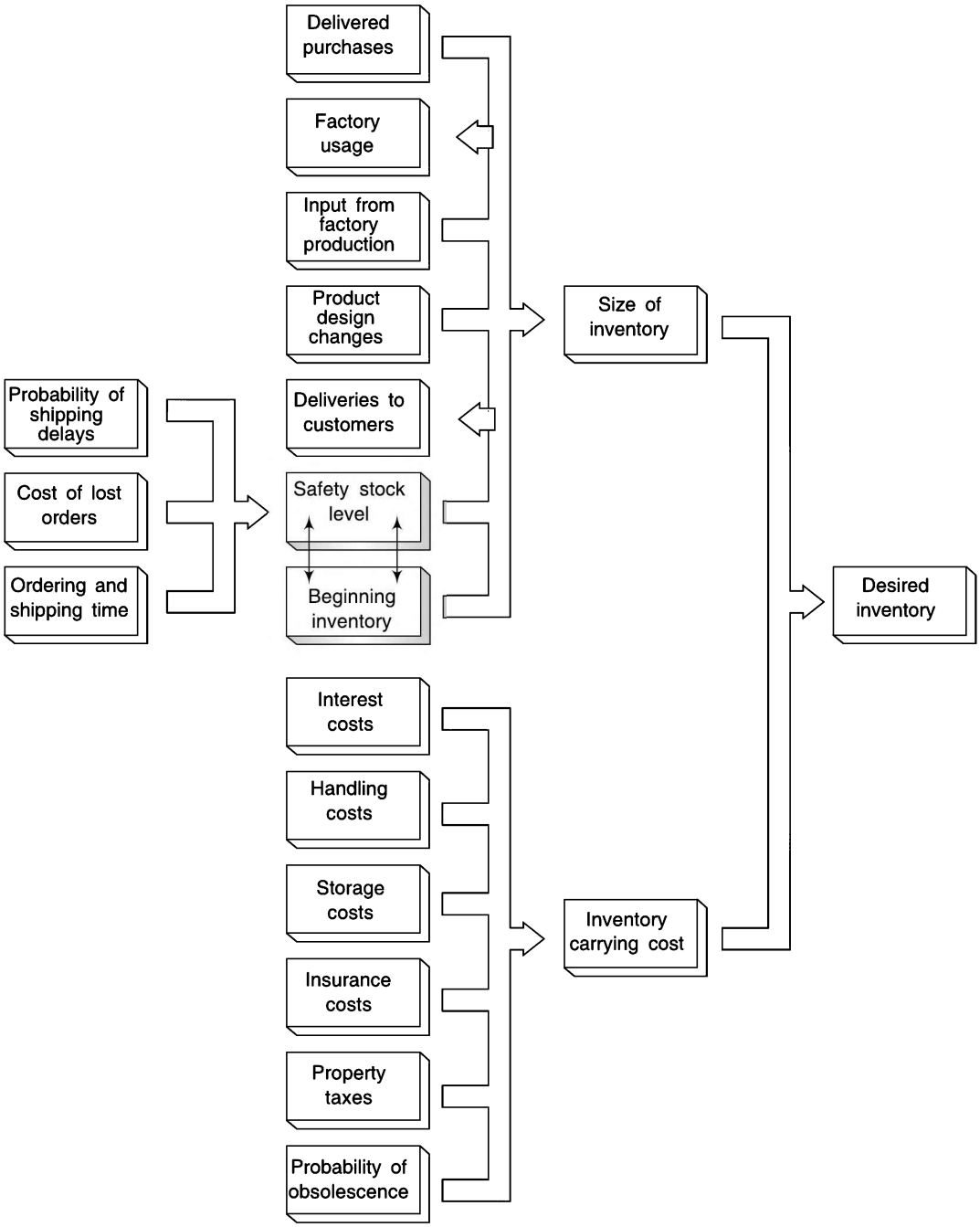
The requirements for a workable feedforward control system may be summarized as follows:

1. Make a thorough and careful analysis of the planning and control system, and identify the more important input variables.
2. Develop a model of the system.
3. Take care to keep the model up to date; in other words, the model should be reviewed regularly to see whether the input variables identified and their interrelationships continue to represent realities.
4. Collect data on input variables regularly, and put them into the system.
5. Regularly assess variations of actual input data from planned-for inputs, and evaluate the impact on the expected end result.
6. Take action. Like any other technique of planning and control, all that the system can do is indicate problems; people must obviously take action to solve them.

*Sometimes called preliminary control, or steering control.

**Figure 18.3**

**System of Inputs for Feedforward Inventory Control.**



## CONTROL OF OVERALL PERFORMANCE

Planning and control are increasingly being treated as an interrelated system. Along with techniques for partial control, control devices have been developed for measuring the overall performance of an enterprise—or an integrated division or project within it—against total goals.

There are many reasons for control of overall performance. In the first place, just as overall planning must apply to enterprise or major division goals, so must overall control. In the second place, decentralization of authority—especially in product or territorial divisions—creates semi-independent units, and these must be subjected to overall control to avoid the chaos of complete independence. In the third place, overall control permits the measurement of an integrated area manager's total effort, rather than parts of it.

Many overall controls in business are financial.

Many overall controls in business are, as one might expect, financial. Business owes its continued existence to profit making; its capital resources are a scarce, life-giving element. Since finance is the binding force of business, financial controls are certainly an important objective gauge of the success of plans. Moreover, sophisticated computer programs can use financial records as strategic tools.[2]

Financial measurements also summarize, as a common denominator, the operation of a number of plans. Further, they accurately indicate total expenditure of resources in reaching goals. This is true in all forms of enterprises. Although the purpose of an educational or government enterprise is not to make monetary profits, any responsible manager must have some way of knowing what goal achievement has cost in terms of resources. Proper accounting is important not only for business but for government as well.

Financial controls, like any other control, have to be tailored to the specific needs of the enterprise or the position. Doctors, lawyers, and managers at different organizational levels do have different needs for controlling their area of operation. Financial analyses also furnish an excellent "window" through which accomplishment in nonfinancial areas can be seen. A deviation from planned costs, for example, may lead a manager to find the causes in poor planning, inadequate training of employees, or other nonfinancial factors.

**INTERNATIONAL PERSPECTIVE**

### Planning and Controlling at Grupo Modelo[3]

Planning and controlling are closely related. Without plans, control is not effective. Mexican Grupo Modelo, best known for its Corona beer, has a worldwide presence. Its early growth was achieved through strategic alliances, followed by an integration strategy. To control its worldwide enterprise, Grupo Modelo measures its success against its competitors. Another critical success factor is its emphasis on product quality as measured by customer expectations. Moreover, manufacturing plants have adopted ISO 9000 certification standards. Close financial control helped the company cope with the Mexican peso crisis as well as the economic slowdown in South America.

## PROFIT AND LOSS CONTROL

The income statement for an enterprise as a whole serves important control purposes, mainly because it is useful for determining the immediate revenue or cost factors that have accounted for success or failure. Obviously, if it is first put in the form of a forecast, the income statement is an even better control device in that it gives managers a chance, before things happen, to influence revenues, expenses, and consequently profits.

### The Nature and Purpose of Profit and Loss Control

The **profit and loss statement** shows all revenues and expenses for a given time, so it is a true summary of the results of business operations.

Since the survival of a business usually depends on profits, and since profits are a definite standard against which to measure success, many companies use the income statement for divisional or departmental control. As it is a statement of all revenues and expenses for a given time, it is a true summary of the results of business operations. Profit and loss control, when applied to divisions or departments, is based on the premise that, if it is the purpose of the entire business to make a profit, each part of the enterprise should contribute to this purpose. Thus, the ability of a part to make an expected profit becomes a standard for measuring its performance.

### Limitations of Profit and Loss Control

Profit and loss control suffers from the cost of the accounting and paper transactions involving intracompany transfer of costs and revenues. But the use of computers has greatly reduced this cost. Duplication of accounting records, efforts involved in allocating the many overhead costs, and the time and effort required to calculate intracompany sales can make this control costly if it is carried too far.

## CONTROL THROUGH RETURN ON INVESTMENT[4]

**Return-on-investment control** measures both the absolute and the relative success of a company or company unit by the ratio of earnings to investment of capital.

Another control technique is that of measuring both the absolute and the relative success of a company or company unit by the ratio of earnings to investment of capital. The return-on-investment approach, often referred to simply as ROI, has been the core of the control system of the Du Pont Company. This yardstick is the rate of return that a company or a division can earn on the capital allocated to it. This tool therefore regards profit not as an absolute but as a return on capital employed in the business. The goal of a business is seen, accordingly, not necessarily as optimizing profits but as optimizing return from capital devoted to business purposes. This standard recognizes the fundamental fact that capital is a critical factor in almost any enterprise and, through its scarcity, limits progress. It also emphasizes the fact that the job of managers is to make the best possible use of assets entrusted to them.

## MANAGEMENT AUDITS AND ACCOUNTING FIRMS

Although many management consulting firms have undertaken various kinds of appraisals of management systems, usually as part of an organizational study, the great-

est interest in pursuing management audits has been demonstrated by accounting audit firms. One of the significant developments has been their entry into the field of management services of a broad consultancy nature. While this has been an attractive field of expansion for these auditing companies, since they are already inside an organization and the financial information to which they have access furnishes a ready window on problems of managing, it does open the question of conflict of interest. In other words, the question is whether the same firm can be in the position of a management consultant furnishing both advice and services and still be completely objective as an accounting auditor. To be sure, accounting firms have attempted to avoid this problem by organizationally separating these two activities.

Accounting firms had enjoyed a great deal of trust, but this changed when U.S. federal prosecutors charged the accounting firm Arthur Andersen with obstruction of justice in connection with the collapse of Enron in 2002.[5]

## THE BALANCED SCORECARD[6]

The occasional overemphasis on financial data may have led to the popularity of the balanced scorecard. Robert Kaplan and David Norton have written extensively on that topic, but the origin of the concept may be traced to the performance measurement by General Electric (GE) in the 1950s and the "dashboard" discussion by French process engineers.

The balanced scorecard is used by business, non-profit organizations, and government to align the company activities with the organizations vision and strategy as well as the improvement of internal and external communication. Thus, the balanced scorecard is not only for control, but also for strategic planning and managing in general. To accomplish the vision and the strategy, four sets of perspectives need to be considered. First, *learning and growth* deals with objectives, measures, targets, and initiatives. The second perspective focuses on the *internal business processes*, that give an indication how well its products and services meet the requirements and expectations of the customers in congruence with the mission of the enterprise. The third perspective focuses on the *satisfaction of the customer*. Even if financial performance is satisfactory, unsatisfied customers may be a leading indicator of future problems. The fourth, the *financial* perspective, is of course important, but should not lead to an unbalanced neglect of the other three perspectives.

The balanced scoreboard approach is congruent with the systems approach used in this book. It focuses on the importance of goals and objectives as well as the close relationship between planning and controlling. Moreover, the importance of the total management process has been stressed, as well as the integration of internal strengths and weaknesses with the external opportunities and threats.* The importance of meeting or exceeding customers' expectations and their satisfaction with the enterprises' products and services has also been emphasized. Finally, the need for creating a surplus for any organization, profit and not-for-profit, is shown in the integrative management model that provides the framework for this book.



*See, for example, the TOWS Matrix discussion in Chapter 5.

## BUREAUCRATIC AND CLAN CONTROL

**Bureaucratic control** is characterized by the wide use of rules, regulations, policies, procedures, and formal authority.

**Clan control** is based on norms, shared values, expected behavior, and other cultural variables.

Organizations exercise control in different ways. One can distinguish between two kinds of structural control: the bureaucratic and the clan control. **Bureaucratic control** is characterized by a wide use of rules, regulations, policies, procedures, and formal authority. This kind of control requires clear job descriptions, budgets, and often standardized tasks. Employees are expected to comply with the rules and regulations and may have limited opportunities for participation.

**Clan control**, on the other hand, is based on norms, shared values, expected behavior, and other aspects relating to organization culture, which was discussed in Chapter 10.[7] Clan control can be illustrated by the use of teams and by organizations operating in a very dynamic environment that requires quick adaptation to changes in that environment. Nokia, the largest wireless phone manufacturer in Finland, tries to keep bureaucracy at a minimum and instead creates an environment consistent with Finnish culture.

www.nokia.com

## REQUIREMENTS FOR EFFECTIVE CONTROLS

All alert managers want to have an adequate and effective system of controls to assist them in making sure that events conform to plans. It is sometimes not realized that the controls used by managers must be designed for the specific task and person they are intended to serve. While the basic process and the fundamentals of control are universal, the actual system requires special design.

Indeed, if controls are to work, they must be tailored to plans and positions, to the individual managers and their personalities, and to the needs for efficiency and effectiveness.

### Tailoring Controls to Plans and Positions

All control techniques and systems should reflect the plans they are designed to follow. They should also be tailored to positions. What will be appropriate for a vice president in charge of manufacturing will certainly not be suitable for a shop supervisor. Controls should also reflect the organization structure, showing who is responsible for the execution of plans and for any deviation from them.

### Tailoring Controls to Individual Managers

Controls must also be tailored to individual managers. Control systems and information are of course intended to help individual managers carry out their function of control. If they are not of a type that a manager can or will understand, they will not be useful. What individuals cannot understand will not be trusted by them. And what they do not trust they will not use.

### Designing Controls to Point up Exceptions at Critical Points

One of the most important ways of tailoring controls to the needs for efficiency

and effectiveness is to design them to point up exceptions. In other words, controls that concentrate on exceptions from planned performance allow managers to benefit from the time-honored *exception principle* and detect areas that require their attention.

But it is not enough merely to look at exceptions. Some deviations from standards have little meaning, while others have a great deal. Small deviations in certain areas may have greater significance than larger exceptions in other areas. A manager might be concerned if the cost of office labor deviated from the budget by 5 percent but might be unworried if the cost of postage stamps deviated from the budget by 20 percent.

Efficient control requires that managers look for exceptions, while effective control requires that managers pay primary attention to things that are most important.

Consequently, the exception principle should be accompanied in practice by the *principle of critical point control*. It is not enough just to look for exceptions; one must look for them at critical points. It is certain that more the managers concentrate their control efforts on exceptions, the more efficient their control will be. Effective control, however, requires that managers pay primary attention to things that are most important.

## Seeking Objectivity of Controls

www.mcdonalds.com

Management necessarily has many subjective elements, but whether a subordinate is doing a good job should ideally not be a matter for subjective determination. If controls are subjective, a manager's or a subordinate's personality may influence judgments of performance and make them less accurate. However, people would have difficulty dismissing control of their performance if the standards and measurements are kept up to date through periodic review. Effective control requires objective, accurate, and suitable standards. McDonald's, for example, is very strict in applying and maintaining the same quality standards in all its restaurants, as you have seen in the McDonald's case discussed in Chapter 1.

## Ensuring Flexibility of Controls[8]

If controls are to remain effective despite failure or unexpected changes of plans, they must be flexible.

Controls should remain workable in the face of changed plans, unforeseen circumstances, or outright failures. If controls are to remain effective despite failure or unexpected changes of plans, they must be flexible.

The need for flexible control can readily be illustrated. A budget system may project a certain level of expenses and grant authority to managers to hire labor and purchase materials and services at this level. If, as is usually the case, this budget is based on a forecast of a certain level of sales, it may become meaningless as a system of control if the actual sales volume is considerably above or below the forecast. Budget systems have been brought into ill repute in some companies because of inflexibility in such circumstances. What is needed, of course, is a system that will reflect sales variations as well as other deviations from plans.

## Fitting the Control System to the Organization Culture

To be most effective, any control system or technique must fit the organization culture.

www.mercedes.com

To be most effective, any control system or technique must fit the organization culture. If an organization has given its employees considerable freedom and participation, a tight control system may go so strongly against the grain that it will be doomed to failure. On the other hand, if subordinates have been managed by a superior who allows little participation in decision-making, a generalized and permissive control system will hardly succeed. People who have little desire to participate or who have not been accustomed to participation are more likely to want clear standards and measurements and specific directions. At one time, Mercedes-Benz, the luxury car maker, publicized that each of its cars underwent checks by many inspectors. But later, with a change in organization culture, a great deal of responsibility for quality was given to individual production workers.

## Achieving Economy of Controls

Controls must be worth their costs.

Controls must be worth their costs. Although this requirement is simple, it is often difficult to accomplish in practice. A manager may have difficulty ascertaining what a particular control system is worth or what it costs. Economy is relative, since the benefits of control vary with the importance of the activity, the size of the operation, the expense that might be incurred in the absence of control, and the contribution the system can make.

An adequate control system will disclose where failures are occurring and who is responsible for them, as well as ensuring that corrective action is taken.

## Establishing Controls that Lead to Corrective Action

An adequate system will disclose where failures are occurring and who is responsible for them, and it will ensure that corrective action is taken. Control is justified only if deviations from plans are corrected through appropriate planning, organizing, staffing, and leading. As mentioned in Chapter 13, General Electric and Motorola aim at Six Sigma quality or no more than 3.4 defects for a million operations.[9]

# SUMMARY

The managerial function of controlling is the measurement and correction of performance in order to ensure that enterprise objectives and the plans devised to attain them are being accomplished. It is a function of every manager, from president to supervisor.

Control techniques and systems are basically the same regardless of what is being controlled. Wherever it is found and whatever is being controlled, the basic control process involves three steps: (1) establishing standards, (2) measuring performance against these standards, and (3) correcting variations from standards and plans. There are different kinds of standards, and all should point out deviations at critical points. Performance can be measured against best industry practices, an approach known as benchmarking.

Managerial control is usually perceived as a simple feedback system similar to the common household thermostat. However, no matter how quickly information is available on what is occurring (even real-time information, which is information on what is happening as it happens), there

are unavoidable delays in analyzing deviations, developing plans for taking corrective action, and implementing these programs. In order to overcome these time lags in control, it is suggested that managers utilize a feedforward control approach and not rely on simple feedback alone. Feedforward control requires designing a model of a process or system and monitoring inputs with a view to detecting future deviations of results from standards and plans thereby giving managers time to take corrective action before problems occur.

Many overall controls are financial, one of which is profit and loss control. Another is the exercise of control through calculating and comparing return on investment. This approach is based on the idea that profit should be considered not as an absolute measure but as a return on the capital employed in a business or a segment of it. The management audit has also been used as a control device. Bureaucratic control is based on rules, regulations, policies, procedures, and formal authority. On the other hand, clan control is influenced by norms, shared values, and expected behavior.

If controls are to work, they must be specially tailored to plans and positions, to individual managers, and to the needs for efficiency and effectiveness. To be effective, controls also should be designed to point up exceptions at critical points, to be objective, to be flexible, to fit the organization culture, to be economical, and to lead to corrective action.

## KEY IDEAS AND CONCEPTS FOR REVIEW

- ✔ Controlling
- ✔ Steps in Controlling
- ✔ Critical Point Control
- ✔ Types of Critical Point Standards
- ✔ Benchmarking
- ✔ Feedback System
- ✔ Real-time Information System
- ✔ Feedforward Control
- ✔ Profit and Loss Control
- ✔ Return-on-investment Control
- ✔ Management Audit
- ✔ Bureaucratic Control
- ✔ Clan Control
- ✔ Requirements for Effective Controls
- ✔ Exception Principle
- ✔ Principle of Critical Point Control

## FOR DISCUSSION

1. Planning and control are often thought of as a system; control is also often referred to as a system. What do these observations mean? Can both statements be true?
2. Why is real-time information not good enough for effective control?
3. What is feedforward control? Why is it important to managers? Besides the example of inventory control mentioned in this chapter, can you think of any other areas in which feedforward

would be used? Select one of these and explain how you would proceed.

4. Why do most controls of overall performance tend to be financial? Should they be? What else would you suggest?
5. "Profit and loss control is defective in that it does not emphasize return on investment; the latter is defective in that it places too great an emphasis on present results, possibly endangering future results." Discuss.
6. If you were asked to institute a system of "tailored" controls in a company, how would you go about it? What would you need to know?
7. In benchmarking, companies compare their performance with best practices. Why do you think firms that have an effective system are willing to share information with other companies?

## EXERCISES/ACTION STEPS

1. Design a control system for measuring the progress that you make in your course work. Apply the feedback and feedforward concepts discussed in this chapter.
2. Interview two managers about the controls used in their companies. Can you identify standards against which performance can be accurately measured? How is performance measured against the standards, and how timely is the reporting of deviations? If deviations are detected, how long does it take before corrections are made in specific situations?

## INTERNET RESEARCH

1. Search the Internet for the term "feedforward control." How does it differ from feedback control?
2. Search the Internet for the term "profit and loss statement." What is it?

## International Case — Wal-Mart in America and around the Globe[10]

By 2001, Wal-Mart had become the second largest company in the world in terms of sales. (The largest is Exxon Mobil). It is also the biggest private employer in the world. Moreover, the company has one of the most sophisticated logistic systems controlled by computers. Yet, its headquarters are located in a small town in Bentonville, Arkansas. The small-town orientation in its business approach contributed to its value-based success story.

Success did not come by accident; rather, it is based on careful planning of a unique strategy, a simple organization structure, an effective human resource policy, an inspiring leadership style initiated by founder Sam Walton, and a clever use of information technology to manage its inventory. When the company made mistakes, it learned from them. One concern is whether the strategy of invading rural areas will also work in the urban areas of America and in the global environment.

## The Background

It all began in 1962 in a small town in Arkansas when Sam Walton noted the need for serving customers in small towns. Retailers such as Kmart and Sears focused on big towns. This created an opportunity for Wal-Mart to fill people's needs in rural areas. This small-town orientation is reflected in the company's values, which emphasize maintaining good relationships with staff as well as suppliers. Sam Walton's values and his philosophy of simplicity and frugality live on after his death. The focus on cost savings enables the company to offer "everyday low prices," which has become the familiar company slogan.

## Planning: From Small Towns to a Global Strategy

Besides the traditional stores, the company has Supercenters with a full line of groceries for one-stop family shopping. They may also include specialties shops with a vision center, tire and lubrication facilities, and photo processing. In addition, Sam's Club is a members-only warehouse club for individual and business members.

Since the early 1990s, Wal-Mart has gone international, starting with a Sam's Club store near Mexico City. Now Wal-Mart operates clubs and stores worldwide in countries such as Argentina, Brazil, Canada, China, Germany, South Korea, Mexico, Puerto Rico, and the United Kingdom, employing more than 2,80,000 people.

The tremendous size of the company gives it a great deal of buying power, which in turn makes it possible to offer goods at low prices, a policy that differentiates Wal-Mart from other retailers. The company is known for its national brand strategy, which allows consumers to compare prices. In addition, Wal-Mart has its own private labels with product offerings in apparel, health and beauty care, dog food, and other items.

In its hub-and-spoke distribution system, merchandise is brought to a distribution center, where it is sorted and prepared for delivery to the stores. These highly automated distribution centers operate 24 hours a day and may serve some 150 stores. Other merchandise is shipped directly from the suppliers to the stores.

## Simple Organization Structure: Centralized and Decentralized

While the company's proprietary information system is centralized, the operation is decentralized with a great deal of authority delegated to local managers in, for example, pricing the merchandise according to the local environment. The autonomy given to store managers makes them in a sense a small shopkeeper who can make decisions to adjust inventory according to local needs. Employees, called associates, are informed and celebrated at the Saturday morning meetings, where they are cheered for their accomplishments. The meetings also provide an opportunity to reinforce the notion that the customer is number one.

Wal-Mart's organization culture is built on three basic values promulgated by Sam Walton. It was established in 1962 and still permeates the organization. The values are (1) respect for the individual, (2) service to the customer, and (3) striving for excellence. Other factors influencing the organization culture include exceeding the expectations of customers, assisting people so that they can make a difference, quickly approaching customers to help, doing today what can be done today rather than postponing it, and pricing for providing value to the customer.

## Human Resource Management: People, the Most Important Assets

Clearly, the organization culture has an impact on the staffing function. Associates are treated with respect in this lean organization. Having a great deal of authority motivates people. Training is decentralized with management seminars offered at the distribution centers instead of at the company headquarters. The company atmosphere encourages employees to submit suggestions, many of them being implemented through the "Yes We Can Sam" suggestion system. Associates are rewarded bonuses for cost reduction through the "shrink incentive plan." Supervisors and managers receive a salary as well as incentive compensation based on store performance. Associates can also participate in a profit-sharing plan with Wal-Mart contributing a certain percentage.

## Leadership by Example: Simple Frugality Communicated Effectively

Sam Walton, the founder, provided leadership by example. His philosophy influenced his style. Once the richest person in America, he was a very frugal man, flying economy class and driving an old pickup truck. Similarly, Lee Scott, the present CEO, drives a Volkswagen Beetle. Sam Walton was a good communicator during his time as CEO, and his style was described as "management by walking and flying around" because of his frequent visits to his stores. Although he felt that trusting people and giving them responsibility was essential in managing people effectively, he also had the necessary control systems. Although Walton passed away in 1992, his legacy and philosophy still permeate his organization, as shown by the spartanly furnished headquarters in Bentonville.

## Controlling a Large Organization: Sharing Information and Technologies with Suppliers

One of the key factors for Wal-Mart's success is the inventory system that uses modern technology. The proprietary computer-controlled logistic system is considered one of the largest in America, ranking just below the Pentagon's system. The store manager can easily find out how his or her department managers are doing and which products are in high demand. Wal-Mart's inventory turns over about twice as fast as the industry average, thus reducing greatly inventory costs. Suppliers, who are considered a part of the Wal-Mart family, also have access to the system and receive real-time data to help them plan for the fast-moving items.

The relationship with suppliers is, however, very businesslike. Contracts are negotiated in no-nonsense rooms with a table and some chairs—no plush offices can be found. What is found, however, is a sign that says Wal-Mart's buyers do not accept bribes, which could influence buying decisions.

## Global Challenges for the Future[11]

Although Wal-Mart has been successful, there are considerable challenges ahead. To continue its growth, Wal-Mart would have to continue aggressively with opening new stores at home and abroad. In addition, product and service offerings need to be expanded, such as providing banking services as well as adding food. International expansion is another way to grow. The company has been successful in the expansion into Canada and Mexico, but other strategies

have been less successful. One such example was the move into Germany, which the company did not plan carefully. Lee Scott attributes the failure to poor management. The company tries to learn from its mistakes and impresses on its associates to provide good service with a smile. In fact, a big problem for the rapidly growing company is developing competent managers and associates.

Domestically, the Wal-Mart image has been hurt by the publicity on the impact of the big retailer on small communities. The "60 Minutes" television program showed how small retailers of small towns could not effectively compete against the giant and were driven out of business. Still, consumers in the small communities were attracted by the everyday low prices. Wal-Mart has also been cited for the low health-care benefits given to its employees. Perhaps partly to divert attention from this issue, the company drew attention to the high health care cost in America with a strategy of reducing drastically prices of several generic drugs in its stores, starting in Florida. While critics see this as a publicity move, consumers welcome it.[12]

One of Wal-Mart's latest attempts to remain the world's largest retailer is to become the neighborhood grocer, which has created fear among other food stores. Food business is big business. People may shop once or more times a week for food. At the same time, they may be enticed to buy other goods Wal-Mart has to offer.[13]

Wal-Mart effectively practiced the managerial functions of planning, organizing, staffing, leading, and controlling, which led to its remarkable success, but challenges remain. Companies such as Costco and Kmart as well as foreign firms such as the French Carrefour and the German Metro (although both are much smaller than Wal-Mart) are attempting to take business away from Wal-Mart.

**Questions**

1. With a saturation of stores in the rural areas in America, can Wal-Mart employ the same strategies for setting up stores in the cities? Why or why not? What difficulties may the company encounter?
2. Can the organization culture, which was so effective in the United States, be transferred to other countries? What changes, if any, would you suggest?
3. Could competitors copy the inventory system of Wal-Mart?
4. Would you like to be a manager at Wal-Mart? Why or why not?
5. What should Wal-Mart do to be successful in other countries?
6. How can Wal-Mart control the global enterprise?

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# MAJOR PRINCIPLES OR GUIDES FOR THE MANAGERIAL FUNCTIONS OF CONTROLLING

As previously mentioned in the other Part Closings, certain fundamental managerial principles or guides have also been identified for controlling.

Each principle has a letter that represents the type of managerial function. The letter "C" in front of the principles therefore indicates that it pertains to the managerial function of controlling.

## Major Principles or Guides for Controlling

From the discussions in the chapters on management control, certain essentials or basic truths have emerged. These, which are referred to as "principles," are designed to highlight aspects of control that are regarded as especially important. In view of the fact that control, even though representing a system itself, is a subsystem of the larger area of management, certain of these principles are understandably similar to those identified in the discussions of the other managerial functions.

## The Purpose and Nature of Control

The purpose and nature of control may be summarized by the following principles:

C1. *Principle of the purpose of control.* The task of control is to ensure the success of plans by detecting deviations from plans and furnishing a basis for taking action to correct potential or actual undesired deviations.

C2. *Principle of future-directed controls.* Due to time lags in the total system of control, the more a control system is based on feedforward rather than simple feedback of information, the more managers have the opportunity to perceive undesirable deviations from plans before they occur and to take action in time to prevent them.

These two principles emphasize that the purpose of control in any system of managerial action is ensuring that objectives are achieved through detecting deviations and taking action designed to correct or prevent them. Control, like planning, should ideally be forward-looking. This principle is often disregarded in practice, largely because the state of the art in managing has not regularly provided for systems of feedforward control. Managers have generally been dependent on historical data, which may be adequate for collecting taxes and determining stockholders' earnings but are not good enough for the most effective control. If means of looking forward are lacking, reference to history, on the questionable assumption that "what is past is prologue," is better than not looking at all. But time lags in the system of management control make it imperative that greater efforts be undertaken to make future-directed control a reality.

| | | |
|---|---|---|
| C3. | *Principle of control responsibility.* | The primary responsibility for the exercise of control rests in the manager charged with the performance of the particular plans involved. |
| C4. | *Principle of efficiency of controls.* | Control techniques and approaches are efficient if they detect and illuminate the nature and causes of deviations from plans with a minimum of costs or other unsought consequences. |
| C5. | *Principle of preventive control.* | The higher the quality of managers in a managerial system, the less will be the need for direct controls. |

To maximize the efficiency of controls, the above three principles should be observed. First, since delegation of authority, assignment of tasks, and responsibility for certain objectives rest in individual managers, it follows that control over this work should be exercised by each of these managers. An individual manager's responsibility cannot be waived or rescinded without changing the organization structure.

The second point to note is that control techniques have a way of becoming costly, complex, and burdensome. Managers may become so engrossed in control that they spend more than it is worth to detect a deviation. Detailed budget controls that hamstring. A subordinate, complex mathematical controls that thwart innovation and cumbersome purchasing controls that delay deliveries and cost more than the item purchased are examples of inefficient controls.

Lastly, most controls are based in large part on the fact that human beings make mistakes and often do not react to problems promptly and adequately. The more qualified managers are, the more they will perceive deviations from plans and take timely action to prevent them.

## The Structure of Control

The principles that follow are aimed at pointing out how control systems and techniques can be designed to improve the quality of managerial control.

| | | |
|---|---|---|
| C6. | *Principle of reflection of plans.* | The more that plans are clear, complete, and integrated, and the more that controls are designed to reflect such plans, the more effectively controls will serve the needs of managers. |
| C7. | *Principle of organizational suitability.* | The more that an organization structure is clear, complete, and integrated, and the more that controls are designed to reflect the place in the organization structure where responsibility for action lies, the more controls will facilitate correction of deviations from plans. |
| C8. | *Principle of individuality of controls.* | The more the control techniques and information are understandable to individual managers who utilize them, the more they will actually be used and the more they will result in effective control. |

First of all, it is not possible for a system of controls to be devised without plans, since the task of control is to ensure that plans work out as intended. There can be no doubt that the more clear, complete, and integrated these plans are, and the more that control techniques are designed to follow the progress of these plans, the more effective the controls will be.

Secondly, plans are implemented by people. Deviations from plans must be the responsibility primarily of managers who are entrusted with the task of executing planning programs. Since it is the function of an organization structure to define a system of roles, it follows that controls must be designed to affect the role in which responsibility for performance of a plan lies.

Although some control techniques and information can be utilized in the same form by various kinds of enterprises and managers, as a general rule controls should be tailored to meet the individual needs of managers. Some of this individuality is related to position in the organization structure, as noted in the second principle. Another aspect of individuality is the tailoring of controls to the kind and level of managers' understanding. Company presidents as well as supervisors have thrown up their hands in dismay (often for quite different reasons) at the unintelligible nature and inappropriate form of control information. Control information that a manager cannot or will not use has little practical value.

## The Process of Control

Control, often being so much a matter of technique, rests heavily on the art of managing, on know-how in given instances. However, there are certain principles that experience has shown have wide applicability.

| | | |
|---|---|---|
| C9. | *Principle of standards.* | Effective control requires objective, accurate, and suitable standards. |
| C10. | *Principle of critical point control.* | Effective control requires special attention to those factors critical to evaluating performance against plans. |
| C11. | *The exception principle.* | The more that managers concentrate control efforts on significant exceptions from planned performance, the more efficient will be the results of their control. |

There should be a simple, specific, and verifiable way to measure whether a planning program is being accomplished. Control is accomplished through people. Even the best manager cannot help being influenced by personal factors, and actual performance is sometimes camouflaged by a dull or a sparkling personality or by a subordinate's ability to "sell" a deficient performance. Good standards of performance, objectively applied–as required by the principle of standards—will more likely be accepted by subordinates as fair and reasonable.

It would ordinarily be wasteful and unnecessary for managers to follow every detail of plan execution. What they must know is that plans are being implemented. Therefore, they concentrate their attention on salient factors of performance—the critical points—that will indicate any important deviations from plans. Perhaps all managers can ask themselves what things in their operations will best show them whether the plans for which they are responsible are being accomplished.

The exception principle holds that managers should concern themselves with significant deviations—the especially good or the especially bad situations. It is often confused with the principle of critical point control, and the two do have some kinship. However, critical point control has

to do with recognizing the points to be watched, while the exception principle is concerned with watching the size of deviations at these points.

| | | |
|---|---|---|
| C12. | *Principle of flexibility of controls.* | If controls are to remain effective despite failure or unforeseen changes of plans, flexibility is required in their design. |
| C13. | *Principle of action.* | Control is justified only if indicated or actual deviations from plans are corrected through appropriate planning, organizing, staffing, and leading. |

According to the flexibility principle, controls must not be so inflexibly tied in with a plan as to be useless if the entire plan fails or is suddenly changed. Note that this principle applies to failure of plans, not failure of people operating under plans.

There are instances in practice in which this simple truth is forgotten: control is a wasteful use of managerial and staff time unless it is followed by action, as the principle of action stresses. If deviations are found in actual or projected performance, action is indicated, in the form of either redrawing plans or making additional plans to get back on course. The situation may call for reorganization. It may require replacing subordinates or training them to do the task required or it may indicate that the fault is a lack of direction and leadership in getting a subordinate to understand the plans or in motivating him or her to accomplish them. In any case, action is implied.

# 19 Control Techniques and Information Technology

## CHAPTER OBJECTIVES

After studying this chapter, you should be able to:

- Explain the nature of budgeting and the types of budgets
- Describe zero-base budgeting
- Discuss nonbudgetary control devices
- Explain time–event network analysis as a major technique of planning and control
- Understand the nature and applications of information technology
- Recognize the importance of computers in handling information
- Explain the opportunities as well as challenges created by the new information technology
- Discuss the digital economy as well as developments in e-commerce and m-commerce
- Understand customer relationship management

Although the basic nature and purpose of management control does not change, a variety of tools and techniques have been used over the years to help managers control. As this chapter will show, all these techniques are, in the first instance, tools for planning. They illustrate the fundamental truth that the task of controls is to make plans succeed; naturally, in doing so, controls must reflect plans, and planning must precede control.

## THE BUDGET AS A CONTROL DEVICE

A widely used device for managerial control is the budget.* Indeed, it has sometimes been assumed that budgeting is the device for accomplishing control. However, many nonbudgetary devices are also essential.

### The Concept of Budgeting[1]

**Budgeting** The formulation of plans for a given future period in numerical terms.

**Budgeting** is the formulation of plans for a given future period in numerical terms. As such, budgets are statements of anticipated results, either in financial terms—as in revenue and expense as well as capital budgets—or in nonfinancial terms—as in

*Primarily because of the negative implications of budgeting in the past, the more positive phrase *profit planning* is sometimes used, and the budget is then known as the *profit plan*.

budgets of direct-labor-hours, materials, physical sales volume, or units of production. It has sometimes been said, for example, that financial budgets represent the "dollarizing" of plans.

## Dangers in Budgeting

Budgets are used for planning and control. Unfortunately, some budgetary control programs are so complete and detailed that they become cumbersome, meaningless, and unduly expensive. In addition, budgetary control may be used for the wrong reasons.

How often have you heard managers say "This is a good idea, but it's not in my budget"? Budgets often control the wrong things. They measure inputs but ignore outputs such as product quality and customer satisfaction. These items are difficult to measure, yet they may be the key to success or failure of the business. Managers may make unwise decisions to meet the budget, especially if incentive pay is given for staying within the budget. They may not invest in research and development, make capital investment for productivity, or invest in activities that will result eventually in greater market share because these investments do not show immediate results. Some of these items should be included in the long-range plan rather than in the one-year budget. Real savings may come from more efficient machines, new products, or other creative ideas, not from adhering to the budget.

## Zero-Base Budgeting

**Zero-base budgeting** Dividing enterprise programs into packages composed of goals, activities, and needed resources and calculating the costs for each package from base zero.

One type of budgeting is **zero-base budgeting**. The idea behind this technique is to divide enterprise programs into "packages" composed of goals, activities, and needed resources and then to calculate the costs for each package from the ground up. By starting the budget of each package from base zero, budgeters calculate costs afresh for each budget period; thus, they avoid the common tendency in budgeting of looking only at changes from a previous period.

This technique has generally been applied to so-called support areas, rather than to actual production areas, on the assumption that there is room for discretion in expenditures for most programs in such areas as marketing, research and development, personnel, planning, and finance. The various programs thought to be desirable are costed and reviewed in terms of their benefits to the enterprise and are then ranked in accordance with those benefits and selected on the basis of which package will yield the benefit desired.

The principal advantage of this technique is of course the fact that it forces managers to plan each program package afresh. As managers do so, they review established programs and their costs in their entirety, along with newer programs and their costs.

# TRADITIONAL NONBUDGETARY CONTROL DEVICES

There are of course many traditional control devices not connected with budgets, although some may be related to, and used with, budgetary controls. Among the more important of them are the use of statistical data of many aspects of the operation, special reports and analyses of specific areas, the operational audit and independent

appraisal by a staff of internal or external auditors, and personal observation such as managing by walking around.

## TIME–EVENT NETWORK ANALYSES

Another planning and control technique is a time–event network analysis called the Program Evaluation and Review Technique (PERT). Before the development of PERT, there were other techniques designed to assess how the parts of a program fit together during the passage of time and events.

### Gantt Charts

**Gantt chart** A bar chart that shows the time relationships between the "events" of a production program.

The first of these techniques was the chart system developed by Henry L. Gantt early in the 20th century that culminated in the bar chart bearing his name (see Figure 19.1). Although simple in concept, this chart, showing time relationships between the "events" of a production program, has been regarded as revolutionary in management. What Gantt recognized was that total program goals should be regarded as a series of interrelated supporting plans (or events) that people can comprehend and follow. The most important developments of control reflect this simple principle as well as basic principles of control, such as picking out the more critical elements of a plan to watch carefully.

### Milestone Budgeting

As a result of the development of further techniques from the principles of the Gantt chart, and with better appreciation of the network nature of programs, "milepost" or "milestone" budgeting and PERT were devised, contributing much to better planning and control of many projects and operations. Milepost or milestone budgeting breaks a project down into controllable pieces and then carefully follow them. Even relatively simple projects contain a network of supporting plans or projects. In this approach to control, milestones are defined as identifiable segments. When accomplishment of a given segment occurs, costs or other results can be determined.

**INTERNATIONAL PERSPECTIVE**

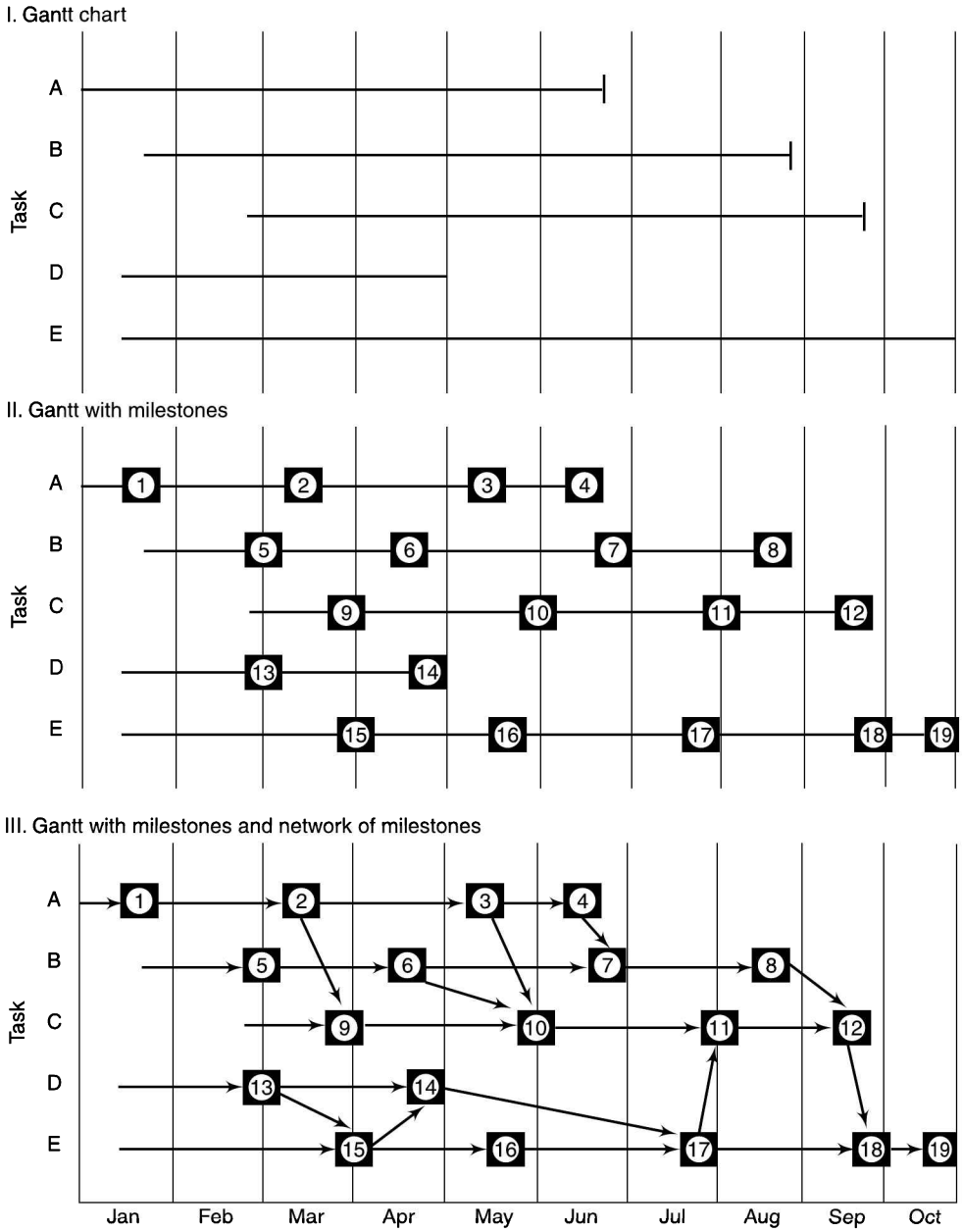
### Planning and Control in Engineering

The best way to plan and control an engineering project is to break it down into a number of events, such as completion of preliminary drawings, an experimental model, a package design, a packaged prototype, and a production design. Or a project might be broken down vertically into subprojects—for example, the design of a circuit, a motor, a driving mechanism, a sensing device, a signal feedback device, and similar components—that can be completed individually, in a time sequence so that components are ready when needed. Milestone budgeting allows a manager to see a complex program as a series of simpler parts and thus to maintain some control through knowing whether a program is succeeding or failing.

**Figure 19.1**

**Transition from a Gantt Chart to PERT.**

The Gantt chart in I below shows the scheduled time of accomplishing a task, such as procurement (Task A), and the related schedules of doing other tasks, such as manufacture of parts (Task B). When each of these tasks is broken down into milestones, such as the preparation of purchase specifications (Task A-1), and when network relationships between the milestones of each task to those of other tasks are worked out, the result provides the basic elements of a PERT chart.



## Program Evaluation and Review Technique (PERT)*

Developed by the Special Projects Office of the U.S. Navy, PERT was first formally applied to the planning and control of the Polaris Weapon System in 1958 and worked well in expediting the completion of that program. For a number of years, it was so enthusiastically received by the armed services that it became virtually a required tool for major contractors and subcontractors in the armament and space industry. Although PERT is no longer much heard of in defense and space contracts, its fundamentals are still essential tools of planning and control. Moreover, in a host of nongovernmental applications, including construction, engineering and tooling projects, and even such simple tasks as the scheduling of activities to produce monthly financial reports, PERT or its companion network technique, the critical path method, may be used.

**PERT** A time—event network analysis system in which the various events in a program or project are identified, with a planned time established for each.

**Major features of PERT** PERT is a time–event network analysis system in which the various events in a program or project are identified, with a planned time established for each. These events are placed in a network showing the relationships of each event to the other events. In a sense, PERT is a variation of milestone budgeting (see Figure 19.1).

Figure 19.2 shows a PERT flowchart for the major assembly of an airplane. This example illustrates the basic nature of PERT. Each circle represents an *event*—a supporting plan whose completion can be measured at a given time. The circles are numbered in the order in which the events occur. Each arrow represents an *activity*—the time-consuming element of a program, the effort that must be made between events. *Activity time*, represented by the numbers beside the arrows, is the time required to accomplish an event.

In this example, only a single time is shown for each activity, but in the original PERT program there were three *time estimates*: "optimistic" time, an estimate of the time required if everything goes exceptionally well; "most likely" time, an estimate based on the time the project engineer really believes is necessary for the job; and "pessimistic" time, a time estimate based on the assumption that some logically conceivable bad luck, other than a major disaster, will be encountered. These estimates are often included in PERT because it is very difficult, in many engineering and development projects, to estimate time accurately. When several estimates are made, they are usually averaged, with special weight given to the most likely estimate; a single estimate is then used for calculations.

**Critical path** The sequence of events that takes the longest time and that has zero (or the least) slack time.

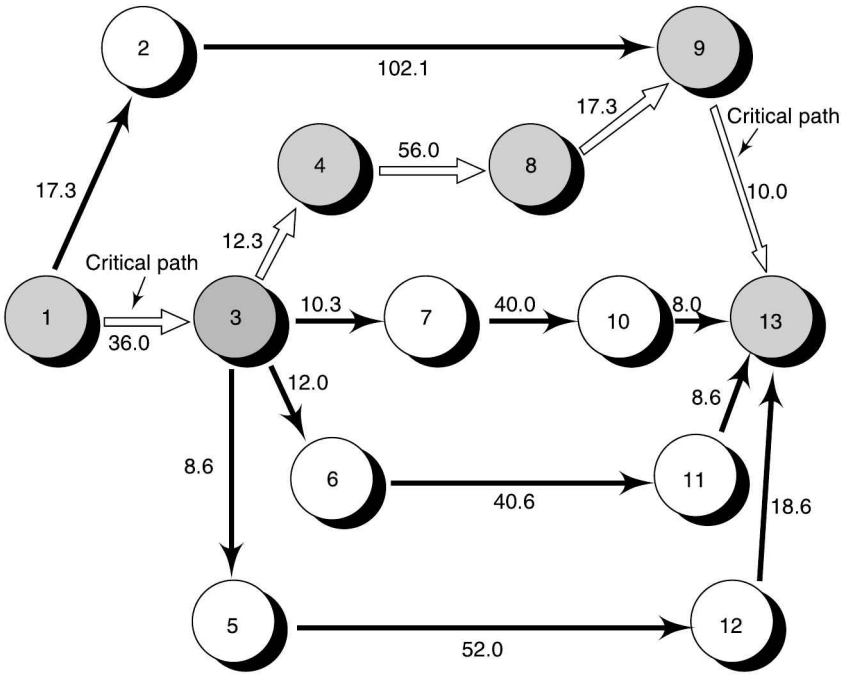
The next step is to compute the *critical path*, which is the sequence of events that takes the longest time and that has zero (or the least) slack time. In Figure 19.2, the critical path comprises events 1–3–4–8–9–13. Over this path, the activity time for this sequence of events is 131.6 weeks; if promised delivery is in 135 weeks, even this critical path will have been completed 3.4 weeks ahead of time. Some of the other paths are almost as long as the critical path. For example, the path 1–2–9–13 is 129.4 weeks. This is not unusual in PERT charts, and it is customary to identify several crucial paths in order of importance. Although the critical path has a way of

*The technique was also separately developed as a critical path method by engineers at the Du Pont Company at virtually the same time. Only PERT is discussed here because the critical path method, although different in some respects, utilizes the same principles.

**Figure 19.1**

**PERT Flow Chart.**

**Events (major milestones of progress) in the major assembly of an airplane (shown with time in weeks): (1) order program go-ahead; (2) initiate engine procurement; (3) complete plans and specifications; (4) complete fuselage drawings; (5) submit GFAE* requirements; (6) award tail assembly subcontract; (7) award wings subcontract; (8) complete manufacture of fuselage; (9) complete assembly of fuselage engine; (10) receive wings from subcontractors; (11) receive tail assembly from subcontractors; (12) receive GFAE; (13) complete aircraft.**
***GFAE: government-furnished airplane equipment.**




changing as key events are delayed in other parts of the program, identifying it at the start makes possible close monitoring of this particular sequence of events to ensure that the whole program is on schedule.

Typical PERT analyses involve hundreds or thousands of events. Even though smaller PERT analyses can be done manually, estimates indicate that when more than 200 to 300 events are involved it is virtually impossible to handle the calculations without a computer.

**Strengths and weaknesses of PERT** There are five important advantages of PERT. First, it forces managers to plan because it is impossible to make a time–event analysis without planning and seeing how the pieces fit together. Second, it forces planning all the way down the line because each subordinate manager must plan the event for which he or she is responsible. Third, it concentrates attention on critical elements that may need correction. Fourth, it makes possible a kind of forward-looking control; a delay will affect succeeding events and possibly the whole

project, unless the manager can make up the time by shortening the time allocated to some action in the future. Fifth, the network system with its subsystems enables managers to aim reports and pressure for action at the right spot and level in the organization structure at the right time.

PERT also has certain limitations. Due to the importance of activity time to its operation, the technique is not useful when a program is nebulous and no reasonable "guesstimates" of schedule can be made. Even in this case, however, insurance can be "bought" by such practices as putting two or more groups of people to work on an event when costs permit. A major disadvantage of PERT is its emphasis on time only, not on costs. While this focus is suitable for programs in which time is of the essence or in which, as so often is the case, time and costs have a close, direct relationship, the tool is more useful when considerations other than time are introduced into the analysis. (There is, however, another program called PERT/cost that does consider costs.)

## ANALYTICS IN MANAGING[2]

In its simplest term, analytics is the science of analysis. Analytics uses computer technology, statistics and operations research to solve business and other problems. Business may use statistical data and quantitative analysis to arrive at decisions. Data is raw material, but to be really useful, data needs to be converted to information that informs people.

**Analytics** is the science of analysis.

Analytics, for example, may be applied to portfolio analysis used by banks to scrutinize accounts in terms of value, risk, and other factors. A bank loan may be more risky in certain geographic locations than in others. The Deery company, for example, saved over $1 million dollars by managing its inventory by using analytics.

## INFORMATION TECHNOLOGY[3]

The developments in information technology greatly facilitate organizational control at a relatively low cost. The systems model of management (Chapter 1) shows that communication is needed for carrying out managerial functions and for linking the organization with its external environment. Communication and the management information system (MIS) are the linkage that makes managing possible.

At the outset, one has to realize the distinction between data and information. *Data* are the raw facts that may not be very useful until they become *information*, that is, after they are processed and become meaningful and understandable by the receiver (see also the communication model in Chapter 17). While this applies to interpersonal communication, it is also true for information technology.

Information technology encompasses a variety of technologies, including various kinds of hardware (e.g., computers, printers), software (e.g., operating systems, word or data processing), and computing and communication technologies (e.g., telecommunication, database management). In fact, new technologies are rapidly developing, such as 3G, the third generation of wireless technology, expanding and enhancing the capabilities of information technology. Even before 3G is widely implemented, the fourth-generation (4G) technology is developed.[4]

**Management information system** A formal system of gathering, processing, and dispersing information internal and external to the enterprise in a timely, effective, and efficient manner to support managers in their jobs.

Information technology has promoted the development of MIS. The definition of the term **management information system** varies. It is defined here as a formal system of gathering, integrating, comparing, analyzing, and dispersing information internal and external to the enterprise in a timely, effective, and efficient manner to support managers in performing their jobs. MIS has to be tailored to specific needs and may include routine information, such as monthly reports; information that points out exceptions, especially at critical points; and information necessary to predict the future.

Electronic equipment permits fast and economical processing of huge amounts of data. The computer can, with proper programming, process data toward logical conclusions, classify them, and make them readily available for use. As noted before, data do not become information until they are processed into a usable form that informs.

**INTERNATIONAL PERSPECTIVE**

### Will China Assume the Role of India in IT Outsourcing?[5]

Much has been written about outsourcing of software projects to India. Indeed, India has some 200,000 IT engineers working on the architecture level. The proficiency of the English language and the high educational level are other strengths of that country. Yet, India is concerned about competitive services offered by Chinese companies. At this point, China is at a competitive disadvantage. Not only is there a shortage of managerial talent, but also English-language skills are lacking. In addition, a fragmented IT industry structure is not conducive for developing IT outsourcing capabilities. Perhaps most important, foreign companies are concerned about intellectual property protection. Despite these handicaps, China is working hard to have a role in IT outsourcing.

Microsoft's joint venture with the Shanghai Municipal Government completes some work for Microsoft Web-based support. To overcome the weakness in English proficiency, employees receive training in improving their language skills. In addition, every week a thirty-minute "English corner" is held. During that time, only English may be spoken. Also top universities require that a large percentage of their course offerings are conducted in English.

Thus, while at the moment, India is a leader in IT outsourcing because of the favorable conditions, the country can expect formidable competition from China.

## Expansion of Basic Data

The focus of attention on management information, coupled with its improved processing, has led to the reduction of long-known limitations. Managers have recognized for years that traditional accounting information, aimed at the calculation of profits, has been of limited value for control. Yet, in many companies, this has been virtually the only regularly collected and analyzed type of data. Managers need all

kinds of nonaccounting information about the external environment, such as social, economic, political, and technical developments. In addition, they need nonaccounting information on internal operations. The information should be qualitative as well as quantitative.

While not nearly enough progress has been made in meeting these requirements, the computer, plus operations research, has led to an enormous expansion of available managerial information. One sees this especially in relation to data on marketing, competition, production and distribution, product costs, technological change and development, labor productivity, and goal accomplishment. When readers of *The Economist* were asked what kind of technology would influence economic activity, the vast majority listed information technology.[6]

## Information Indigestion and Intelligence Services

Managers who have experienced the impact of better and faster data processing are justly concerned about the danger of "information indigestion." With their appetite for figures whetted, the data originators and processors are turning out material at an almost frightening rate. Managers are complaining that they are being buried under printouts, reports, projections, and forecasts that they do not have time to read or cannot understand or which do not fill their particular needs.

One attempt at solving the problem of information overload is the establishment of intelligence services and the development of a new profession of intelligence experts. The service is provided by specialists who know (or find out) what information managers need and who know how to digest and interpret such information for managerial use. Some companies have established organizational units under such names as "administrative services" or "management analyses and services" for making information understandable and useful.

## Managing by the Numbers[7]

Since its early days of the development of managerial thought, attempts have been made to numberize managing. Frederick Taylor, the father or scientific management, aimed at improving productivity and efficiency (Chapter 1 in this book). Similarly, operations management focused on the activities necessary for producing goods and services (Chapter 20). Various tools were used to quantify activities and tasks. Edward Deming, the quality guru, used statistical tools to improve quality (Chapter 1). More recently, the Six Sigma tool (see GE's Jack Welch in Chapter 13) focused on quality and customer satisfaction. More recently, attempts are made to model workers in large organizations such as IBM by using concepts such as "numerati". The idea is to build mathematical models of people in a large organization.

Modeling organization people may be illustrated by a project using numerati concepts in a worldwide organization such as IBM. Thus, the job may be described in numerical terms, and so would be the skills needed. People may be drawn from different organizational units located around the world. The budget would also be stated in numbers. To find the suitable people, numerical profiles can be searched in a huge database. For this complex project, concepts such as described in the

book The Numerati authored by Stephen Baker may be employed. The attempt is to quantify human variables through the uses of very large databases by combining factors to achieve productivity and efficiency. These databases may consist of employees' emails, cell phone conversations, electronic calendars, and computer messages. These bits of data may also identify informal networks.

But this approach must be accompanied by words of caution: People may resist being treated as numbers. They may feel that their privacy has been violated and they want to be treated as dignified human beings, not as commodities. The approach may recall the negative aspects of industrial engineering and companies may be perceived as the BIG BROTHER.

As pointed out in the discussion of the management theory jungle (Chapter 1), numerical approaches to management such as the mathematical or "management science approach" or the reengineering or total quality approaches made great contributions to the development of management thought, but still many human variables cannot be quantified. The authors of this book, as well as most management textbook authors, recognize that the best approach is to organize management knowledge according to the managerial functions of planning, organizing, staffing, leading, and controlling, the framework of this book.

## THE USE OF COMPUTERS IN HANDLING INFORMATION

The computer can store, retrieve, and process data so that they become information. Often a distinction is made between kinds of computers. The *mainframe* is a full-scale computer, often costing millions of dollars, that is capable of handling huge amounts of data. The most powerful mainframes are the supercomputers, which are used for engineering, simulation, and the manipulation of large databases.** The *minicomputer* has less memory and is smaller than the mainframe. This kind of computer is often connected with peripheral equipment. The *microcomputer* is even smaller and may be a desktop computer, home computer, personal computer, portable computer, or a small computer for a business system. Increasingly, however, minicomputers are used by large organizations either as stand-alone computers or as parts of a network.

The computer can store, retrieve, and process data so that they become information.

The distinction between the various classes of computers is disappearing with the introduction of the microcomputer and the linkage of smaller computers into a network. Some tasks that previously required a powerful computer can now be carried out by smaller computers that are hooked together. The food biotechnology company Monsanto uses grid technology to gain such computing power. Rather than buying larger computers, smaller computers are connected. Although grid technology was developed in academia and government research laboratories, it has found its way into business.[8] It should be noted that the full utilization of the hardware (the computers) also depends on the development of software programs.

*The supercomputer was developed by the legendary Seymour Cray, who has been called the father of supercomputing. The first supercomputer was used at Los Alamos National Laboratory in 1978, costing some $8.8 million.

Among the many business applications of the computer are material requirement planning, manufacturing resource planning, computer-aided control of manufacturing machinery, project costing, inventory control, and purchasing. Some of the tools will be discussed in the next chapter. The computer also aids design and engineering, an application that made the U.S. space program possible. Then there are of course the many uses in processing financial information such as accounts receivable, accounts payable, payroll, capital budgeting, and financial planning. Computer-aided communication impacts not only on decision-making but also on organizational design.

**INTERNATIONAL PERSPECTIVE**

### UPS: From Time Management to Information Technology (IT)[9]

In delivery business, time is critical for United Parcel Service Inc. (UPS) and FedEx Corporation, two fierce competitors. In the 1980s, UPS was known for its low-tech, but labor intensive trucking operations with a focus on intensive time-management studies. By 2006, however, the emphasis is on IT, partly driven by FedEx that was known for high-speed, overnight service. To improve speed, UPS customers can prepare their own labels even before the package is picked up by going to the UPS's website or using software provided by the company. By using the satellite global-positioning system the company can quite accurately estimate the delivery time. In the future, UPS may even be able to schedule delivery by appointment.

## The Impact of Computers on Managers at Different Organizational Levels

Information needs vary at different organizational levels. Therefore, the impact of computers will also be different. At the supervisory level, activities are usually highly programmable and repetitive. Consequently, the use of computers is widespread at this level. Scheduling, daily planning, and controlling of the operation are just a few uses.

Middle-level managers, such as department heads or plant managers, are usually responsible for administration and coordination. Much of the information important to them is now also available to top management if the company has a comprehensive information system. For this reason, some people think that the computer will reduce the need for middle-level managers. Others predict that their roles may be expanded and changed.

Top-level managers are responsible for the strategy and overall policy of the organization. In addition to determining the general direction of the company, they are responsible for the appropriate interaction between the enterprise and its environment. Clearly, many of the tasks of chief executives are not easily programmable. Yet, top managers can use the computer to retrieve information from a database

to facilitate the application of decision models. This enables the company to make timely responses to changes in the external environment. Still, the use of the computer will probably affect the jobs of top managers less severely than it will affect the jobs of those at lower levels.

## The Application and Impacts of Microcomputers

The personal computer is becoming increasingly appealing to managers because it is flexible and relatively inexpensive and can be used more quickly than the mainframe computer. Its applications include the following: spreadsheets, graphic presentations, financial analyses, budget preparation, forecasting, simulation modeling, word processing, e-mail, database access, and time-sharing.

The implications of the increasing use of the microcomputer are manifold. There is a need for specialized staff support, training for managers and nonmanagers, and a redefinition of jobs. For example, the distinction between line and staff is becoming less clear. The information that was formerly gathered by staff can now be obtained with ease by line managers when they access a common database. On the other hand, information that was the prerogative of upper-level managers can also be made available to personnel at lower levels, possibly resulting in the shift of power to lower levels in the organization. But not all information should be accessible to all people in the company. Thus, one of the problems currently faced by many firms is maintaining the security of information.

**LEADERSHIP PERSPECTIVE**

### Netbooks: The Product for Difficult Economic Times?[10]

PC makers have been suffering during the 2008-2009 economic crisis. The bright spot in the PC industry is the Windows-based netbook costing some US $300 to $500. Walt Mossberg, *the Wall Street Journal* columnist, called the netbooks a "relatively new category of small light, minimalist, and cheap laptops[11]." Besides the low price, netbooks typically have a long battery life — up to nine hours. They use the low-power Intel Atom processors and the familiar Windows XP Home operating system. The screens of the netbooks are usually 8" or 10" and they weigh around three pounds.

There are also limitations of netbooks such as small screens. They tend to have lower resolution than the more expensive laptops. Still the Internet-connecting, low-weight netbooks offer an inexpensive alternative to laptops.

## The Twitter Phenomena[12]

One of the recent technology phenomena is Twitter where people broadcast short messages, containing not more than 140 characters. It is a free social networking service with an author who has followers. The messages can be to the public or

they can be restricted to friends. The program opens with a question: "What are you doing?" which, however, many people do not answer directly. Nevertheless, it is an opening to connect.

Twitter started in 2006 during a brainstorming session and is growing rapidly since then. Tweets are used not only between and among friends, but also by politicians, news reporters (e.g. CBS in the U.S.), protestors, and people who just want to communicate their ideas. The candidates in the 2008 US presidential election used Twitter. In 2008, during the Mumbai attack, eyewitnesses tweeted vital information such as the location of hospitals. When the US Airways airplane ditched in the Hudson River in New York, news was sent before news reporters arrived. During the 2009 Iranian election, protestors effectively used twitter communication.

Twitter raised a lot of money from venture capital firms. However, the long-term profitability and the business model are not clear at this time. While the Internet may be the next "big thing," new technologies are evolving and could threaten the future of Twitter as well as other technologies.

## OPPORTUNITIES AND CHALLENGES CREATED BY INFORMATION TECHNOLOGY

Preventing the unauthorized use of information is just one of many challenges created by information technology. Other challenges as well as opportunities brought by information technology include overcoming resistance to the use of computers, adapting speech recognition devices, telecommuting, installing computer networks, and using the Internet.

### Resistance to Computer Use

www.kp.org

While high school students may feel comfortable using the computer, some managers fear it. One study revealed that the typical executive affected by this phobia is male, is about 50 years old, and has worked most of his life for the same company. Some managers are reluctant to use the computer because they are afraid of looking unskilled if they are not able to understand the new technology or do not have the typing skill often necessary for entering data into the computer. In the past, typing was considered the task of the secretary, not the manager. At Kaiser Permanente, the largest health maintenance organization in the United States, doctors resisted the new information technology because they were required to enter the medical records of patients. To encourage use, doctors were given checklists that could be easily filled out on-screen. When the benefits were realized, resistance decreased.

### Speech Recognition Devices

One way to encourage the use of computers is through speech recognition devices. The aim is to put data into the computer by speaking in a normal manner, rather than by using the keyboard. Several companies are working on such devices. One program called Dragon Naturally Speaking by Nuance is continuously improved with

each new edition.* Simple speech recognition has been in limited use for some time. Merely expanding the vocabulary through a larger memory is not enough. Imagine the program sophistication needed to distinguish between similar sounds (in the English vocabulary) such as "then" and "than" or "to" and "too" and "two." Despite the complex problems, some people think that the efforts made in this area will result in products that may revolutionize office operations.

After a slow start, speech recognition is increasingly used at call centers of telephone companies, airlines, and financial service firms.[13] The cost-effectiveness of this technology is one of the major factors for its increasing use. Computers have become less expensive, and broadband access to the Internet and wireless Ethernet have become more common. Still, the greatest impact of speech recognition may be in the car. Perhaps the most important impediment to this development is, at least in the United States, the disagreement about a common industry standard.

## Telecommuting

**Telecommuting** Working at a computer terminal at home instead of commuting to work.

The widespread use of computers and the ease of linking them through telephone lines (or even wireless devices) to a company's mainframe computer have led to **telecommuting**. This means that a person can work at a computer terminal at home instead of commuting to work. Some of the advantages claimed include greater flexibility in scheduling work, the avoidance of traffic congestion, and a reduced need for office space.

The futurist Alvin Toffler envisioned an "electronic cottage" with computer terminals installed at home. But John Naisbitt, in his book *Megatrends*, is skeptical of the idea and suggests that, after telecommuting for some time, workers will miss the office gossip and the human interaction with colleagues.[14] Some companies that have contracted work to telecommuters have been criticized for not providing the benefits usually given to office workers. At Pacific Bell, however, participants in the voluntary program are considered full-time employees. Moreover, some employees got to the office at least once a week to check their mail and to mingle with coworkers.

With the worsening traffic congestion, especially in metropolitan areas, one may see a greater use of telecommuting. It is doubtful, however, that it will replace the office as we know it today.

## Computer Networks

The widespread use of stand-alone computers often results in duplication of efforts. The database in the mainframe or the minicomputer, for example, may not be accessible from the desktop computer. Therefore, computer networks have been developed that link workstations with each other, with larger computers, and with peripheral equipment. The interconnection allows users at several workstations to communicate with each other as well as to access other computers. Moreover, workstations can be connected to costly hardware that may be underutilized by a single user. For example, laser printers or tape backup units for saving data files can be shared.

*As of 2011, the program is in Version 11.

There are many other applications of computer networks, such as e-mail and the collection, dissemination, and exchange of data, information, and knowledge. Although computer networking is still in its infancy, new technological developments are rapidly changing the system of information handling.

**INTERNATIONAL PERSPECTIVE**

### Cisco's Approach to "Convergence"[15]

Technology undergoes rapid changes as illustrated by convergence which means integrating computers, entertainment systems, and the Internet. Many players are in that market ranging from Apple to Hewlett-Packard to Microsoft to Sony, and to Cisco. Cisco's competitive strengths are in networking gear with, for example, the Linksys product. To focus on the customer, Cisco introduced the Linksys Wireless Home Audio multi-room system. Other Cisco brands include large-screen TV setup boxes by Scientific Atlanta and Flip by Pure Digital producing very simple video cameras. By combining Cisco's strengths in networking, the company hopes to take advantage of the current networking trend.

## The Internet

The **Internet** is the largest network of computers and a network of networks.

http://www.aol.com

www.compuserve.com

http://www.earthlink.net

www.att.com

The Internet is the largest network of computers. Actually, it is a network of networks. It ranges from large formal networks at AT&T to informal ones that can be accessed by anyone. The Internet started at the U.S. Department of Defense in 1969 with the purpose of linking it with military research contractors and universities conducting research for the military. Now governments, universities, companies, and anyone with a computer and a modem can use the Internet. Private persons often use an online service such as America Online, CompuServe, Earthlink, or AT&T to send and receive e-mail, "chat" with other people anywhere in the world, and retrieve information (e.g., from an online library or newspaper). They can check the weather forecast or sports results. The Internet is also an excellent tool for conducting company research and doing business.[16] Another common use is for discussion on bulletin boards of any topics, ranging from computer assistance to hobbies and sports events. Building online communities is one purpose of the Internet.[17]

The Internet received a boost through the World Wide Web, which was developed at the European Particle Physics Laboratory. The standard for representing data on the Web is called Hypertext Markup Language (HTML). The Web, in turn, got a boost from the Mosaic browser released by University of Illinois student Marc Andreessen. With Mosaic, one has an easy-to-use tool for accessing information around the world, such as visiting a company's webpage to learn about the company and its products and services. Mosaic could be downloaded for free. Later, Netscape, the commercial product of Mosaic, was offered by Andreessen, who became a multimillionaire at the company's public offering in 1995.

No one is sure how many people use the Internet. The number of users has been estimated at about 2,000 in 1993, more than 33 million in 1996, and possibly between one and two billion by 2001.[18] And the number is climbing.

The Internet is transforming many industries, ranging from telecommunication to travel. It is inexpensive, it will soon be found everywhere, and it is an open system. It has created Internet-related companies such as Netscape, Yahoo, Cybercash, and many others that did not exist a few years ago.[19] It is also transforming the way business is conducted and service is delivered. For instance, one can have a personalized news retrieval service through PointCast software. At regular intervals, the software connects through the Internet to the PointCast server to collect the kind of information requested.[20]

Electronic communication has a great impact on language too. A new cyber jargon has created words such as web browser (a program for exploring the Web), newsgroup, World Wide Web, netiquette, and of course, Internet.[21] Language links the world, and the most widely used language on the Internet is English. It has been estimated that 80 percent of all information stored in computers is in English. How much of the information on the Internet is in English is not known, but almost all scientific material on the Internet is in English. To advance in one's career and to function in the global environment, people will need to know at least some English, even if it is not their native language.

The Internet has also political and social implications.[22] In Asia, for example, governments want their countries to be technologically advanced in cyberspace, yet they may consider limiting objectionable or socially or politically sensitive material transmitted on the Internet.

**INTERNATIONAL PERSPECTIVE**

## Apple's iPhone—A Truly Global Product[23]

It is very unusual that customers would stand in line to purchase a newly introduced product. They, however, did that when Apple introduced the 3G iPhone, the phone that was technologically ahead of its time when it was introduced on July 11, 2008 in America as well as in many other countries. Clearly, it was not the traditional cell phone, but had some features of a minicomputer. Why, then, were people spending hours waiting to obtain the iPhone? What are some of the features that made this phone so special? Here are some features: It can synchronize with the names, phone numbers, addresses, email addresses, and other information in the contact list. Moreover, it can connect with calendars photos, podcasts, movies, and even TV shows. One of the distinguishing features is that others can develop applications that can be accessed for free or they can be purchased from the iTunes store. One of the feature popular with companies is to set up "push accounts," that is when new data is entered, such as email, it is communicated directly to the computer and the iPhone wirelessly. This information can be obtained through the cellular or Wi-Fi connection.

The 3G iPhone is a great improvement over the older iPhone that was introduced about a year earlier. The new phone, however, is much faster. At the same time, the price has been greatly reduced. Thus, the price reduction and the fast speed, besides other features, were attracting customers and made them stand in line.

This truly is a global phone. One part was developed in a garage in India, it was designed by Apple computers in the Silicon Valley near San Francisco, and it is produced in China. Partly through this cooperation, the new iPhone could be offered at $199 for the 8G – that is half the price of the previous, much slower phone. But people object that the only carrier in the U.S. was AT&T. In other countries, the iPhone was also limited to a designated carrier or few carriers; for example in Germany it is T-Mobile.

Another feature is the Global Positioning System (GPS) which works around the world used for finding direction. One can also multi-task on the phone. With the camera, one can take pictures and email them to a person on the contacts list. One also has access to the Apple Store where one can purchase music and video. A rather unique feature is the App Store in which developers from all over the world can offer their application programs for the iPhone which allows game playing, obtaining news, and sports stories. These features and the international keyboard layouts make the iPhone a truly global product.

While the 3G Phone was an important innovation, technology rapidly changes. In 2011, the 4S iPhone with a dual-core A5 chip, an 8MP camera, and the Siri feature which allow using voice command, was introduced. The iOS 5 is the most advanced operating system for mobile devices. Again, enthusiasts were standing in line at the Apple stores to purchase the newest iPhone.

## Other Types of Networks

Besides the Internet, there are other types of networks. The **intranet** is a network that applies computer and Internet technologies to an organization or selected groups within the organization. Similarly, the **extranet** also uses computer and Internet technologies, but it connects selected users inside as well as outside the organization. For example, a purchasing agent may be linked to certain vendors for conducting selling and buying transactions.

## Groupware

**Groupware** Software that enables a group of people on a network to collaborate over long distances at the same time.

Networks facilitate the management process and other business activities. A group of people on a network can collaborate over long distances at the same time using **groupware**. This software allows a document to be shown to several users on their monitors and for them to comment or make changes to the document. Thus, people who may be located in different parts of the world can collaborate on the same task simultaneously.

## Freeware: The Search for a Business Model[24]

There is no general agreement on the freeware term. It usually pertains to fully functional software with no cost to the user. However, restrictions may be imposed on the user such as that it is only for personal use and not for commercial purposes. Note that freeware is different from shareware which generally requires the user to pay after an initial period or to upgrade to extra functionality.

Today, much information that previously cost money can now be obtained free. For example, Wikipedia is a web based free encyclopedia based on the collaboration of contributors. Many websites replaced agents or provide access to companies. Trading websites replaced agents; Turbo Tax, the accounting software, replaced accountants, and the search engines replaced travel agents. There are also other free websites. For example, on the iPhone or iPod Touch one can listen to music for free on Pandora; on Hulu one can see movies for free, and Skype allows free phoning. YouTube is a video sharing website that is used by individuals and organizations. For example, in 2009 the Vatican entered the new technology world with its own website on YouTube (http://www.youtube.com/vatican?gl=DE&hl=de). The program is available in several languages. So what is the business model for those companies who provide free access to their offerings?

The traditional model was as follows: First it started with an idea, and then money was raised to bring the idea to the market. If successful, additional money was obtained to expand the business, and finally a big company bought the entrepreneurial product or service. However, during the financial global meltdown in 2008, it became difficult to raise money and companies were searching for new business models. The popular Facebook has many customers, but it was also ineffective in raising advertising money. The widely used YouTube was also struggling. One may also be wondering how Microsoft could compete in markets where word processors and spreadsheets are available for free. Microsoft created a web version of its business software and made it available for free to small and young enterprises that are less than three years old and have revenues of less than $1 million. The hope was that as the firms grow, they will buy and use Microsoft's programs.

**Freeware** usually pertains to a fully functional software with no cost to the user.

While users of software benefit from freebies, companies are struggling to find a profitable business model.

**INTERNATIONAL PERSPECTIVE**

## WiMax—A Breakthrough Technology?[25]

**WiMax** stands for Worldwide Interoperability for Microwave Access using Intel chips

What is WiMax? The term stands for Worldwide Interoperability for Microwave Access using Intel chips. It is an extension of the Wi-Fi wireless network used in homes and businesses with a limited range. In contrast, WiMax can extend its range up to 30 miles and is much faster, making it suitable for wireless access. The plan is to include it in PCs, smart phones, TVs, and TIVOs. Major companies plan to use the technology including Nokia, Samsung, and Sprint. The problem is that at this time (2007), Sprint is losing customers and is relatively weak when compared

with AT&T, Verizon Wireless, and T-Mobile. WiMax, however, has the great potential for search, email, and other web services provided by Google. Moreover, satellite companies may use WiMax for TV services. Only the future will tell whether the breakthrough WiMax technology will fulfill its potential.

### Information Security[26]

With the growing use of information technology, the concern for security also increases. Not only businesses but also individuals are vulnerable to computer break-ins or interception or alteration of electronic transmissions. A hacker (someone who breaks into a computer) may alter or even destroy bank or other records. Protection of computers can be afforded through encryption, whereby a secret code is used to scramble the message so that it is not readable. The use of a firewall also provides some protection. Firewalls come as software programs (e.g., Norton Personal Firewall or Zone Alarm Pro) or as hardware such as the Ethernet router. A great variety of antivirus programs protect against computer viruses or worms, which may cause extensive damage to computers and networks. Of additional concern are the people who work with information systems in organizations. They need to be responsible, be trained, and be held accountable for their behavior with severe penalties attached for breaching security. Individuals and companies also should protect data by regularly making backup copies and storing them in a secure place, perhaps outside their place of work.

## THE DIGITAL ECONOMY, E-COMMERCE, AND M-COMMERCE

Alan Greenspan, chairman of the U.S. Federal Reserve Board, one of the most influential persons in the world of finance, stated in 1999: "The newest innovations, which we label information technology, have begun to alter the manner in which we do business and create value, often in ways not readily foreseeable even five years ago." **e-commerce**—business transactions on the Web—is changing the way we do business.

### The Emerging Digital Economy[27]

Information technology affects most aspects of business and personal life. While computer power is growing rapidly, its price is dropping dramatically. The Ford Taurus car of today has more computing power than the million-dollar mainframe computer in the Apollo space program. Information technology raises productivity not only in the production and distribution of goods but also in services. Productivity improvement, in turn, results in higher living standards. This new technology impact is global, increasing competition and innovation. The ability to easily process vast amounts of data in research and development has shortened the development time of new products, speeding up their introduction to the market.[28]

One of the major impacts of the Internet is on the way business is conducted. Relationships with suppliers and customers are changing dramatically. Telecommuni-

cation and information technology have contributed greatly to the longest peacetime economic expansion in the United States. The investment in those technologies finally paid out. Today, we have e-everything: e-mail, e-commerce, e-business, e-cash (use of smart cards and digital cash), e-travel, e-finance, e-loan, e-music, e-books, e-stamps, and many more e-activities.

The economic gains of e-commerce come from the lower costs of online companies (when compared to brick-and-mortar firms with physical stores), reduction in distribution costs, and the elimination of intermediaries. Buyers benefit from being able to compare prices and select the best choice from the comfort of their home or office. How can the brick-and-mortar businesses with their higher costs compete with e-businesses? Stores like Kmart and Wal-Mart now also transact their business through the Web, becoming "clicks and mortar" or "clicks and bricks" companies. This means you can make purchases with a click of the mouse or by physically visiting their stores.

The Internet facilitates four kinds of transactions, as shown in Figure 19.3. These transactions are:

1. *Business to consumer (B2C)*. Ordering books or other items from Amazon.com or buying a computer from Dell online are examples of B2C transactions. The Safeway grocery store delivers Web-ordered groceries to customers' home.
2. *Consumer to business (C2B)*. An example of C2B transaction is the bidding for airline tickets by would-be flyers through Priceline.com.
3. *Consumer to consumer (C2C)*. The eBay auction website offers C2C transactions, through which individuals can sell items.
4. *Business to business (B2B)*. B2B transactions are probably going to have the greatest impact on the economy. For example, the two largest car manufacturers, General Motors (GM) and Ford, plan to transfer all purchasing to the Web within the next few years. GM claims that its website will be the world's largest virtual marketplace. So what could this mean to the consumer in the

**Figure 19.3**

**Matrix for E-Commerce.**

**Adapted from "E-Commerce Survey", *The Economist,* February 26, 2000, Insert p.11**

| | **Consumer** | **Business** |
|---|---|---|
| **Consumer** | C2C<br>*eBay*<br>(auction) | C2B<br>*Priceline*<br>("you name the price" travel offers) |
| **Business** | B2C<br>*Amazon* (books, etc.) *Travelocity* (travel) | B2B<br>*Ford, General Motors, Dailmer Chrysler*<br>(manufacturers to suppliers) |

future? Ford and GM may build cars to order for delivery in just a few days; just like you order today customized computers from Dell.[29] It is possible that GM and Ford will become virtual companies with expertise in car design and brand marketing.

www.covisint.com

Covisint, the new joint venture between Ford, GM, DaimlerChrysler, and Renault/Nissan, could become the exchange where suppliers trade with each other.[30] There is concern that this may lead to monopolistic practices, which may prompt the U.S. Justice Department to investigate.

www.orbitz.com

In the airline business, another battle takes shape. The five largest U.S. airlines—Continental, Delta, Northwest, United, and American Airlines—have a common website called Orbitz.com. This site collides with the traditional travel agents as well as with online travel agents such as Travelocity and Expedia (a Microsoft company) by trying to undercut their prices.[31]

www.nokia.com
www.lucent.com

Three-quarters of all e-commerce is conducted in the United States, from which 90 percent of all commercial websites originated.[32] However, the country with the most internet hosts per inhabitant is Finland; the United States ranks second. Among the world's most admired companies identified by *Fortune* magazine, many are in the information technology business.[33] Here are some familiar names: Microsoft, Dell, Cisco Systems, Intel, Nokia, and Lucent Technologies. However, in 2002, some of the so-called dot-com companies fell out of favor with investors. Outside the information technology industry, many firms use sophisticated technologies to gain a competitive advantage, including Wal-Mart, General Electric, and Ford.

## m-Commerce and Wireless Communications

www.palm.com

While e-commerce is changing the way business is conducted, wireless communications and m-commerce (mobile commerce) are emerging to take it further. Japan and Europe have the leading edge in this area. However, Europe lags behind Japan, even though m-commerce and wireless applications are expected to increase greatly in Europe in the next few years. Companies such as BellSouth, Motorola, Qualcomm, Ericsson, Lucent, Nokia, and Microsoft are trying to exploit opportunities in wireless communications. Devices using the Wireless Application Protocol (WAP) include cell phones and personal digital assistants (PDAs) such as the Palm Pilot. Wireless applications may include business transactions, provision of financial and travel information, and community sites for chatting or sending e-postcards.

**INTERNATIONAL PERSPECTIVE**

### Mobile Phone Services

www.docomo.com

In late 2001, NTT DoCoMo announced the introduction of the 3G mobile phone service for Japan, putting the country ahead of Europeans and Americans with this new technology. Many countries have been using text messaging with comparatively low-level technology for some time. The Japanese are fortunate to be able to use both high and low technologies. 3G allows very high-speed connections,

the display of color screens and graphics, and even video calls. NTT DoCoMo is the leader in mobile communications in Japan and the largest telecommunication operator on the globe. The company has already set its goal on the future with its Vision 2010 consisting of MAGIC, which stands for mobile, anywhere, global, integrated, and customized personal service. At this time, however, the focus is on the introduction of the 3G service and text messaging.

The European companies that introduced 3G have incurred heavy debt in acquiring 3G licenses and may not have the necessary resources to build the required extensive network. These companies are concerned whether customers will be willing to pay for these new services.

Some Europeans and Asians use a much less sophisticated technology and may not be willing to subscribe to the costly 3G services. Text messaging (or short message service, SMS) allows the user to send short messages from one mobile phone to another. This service has been widely used in Europe (especially in Sweden and Italy) as well as in Asia. In contrast, it is hardly used at all in the United States, partly because mobile phones are less common there (40 percent of the people use it) than in certain countries in Europe (with up to 70 percent usage). Although text messaging is cumbersome, it is inexpensive.

The developments in e-business, e-commerce, and m-commerce provide great opportunities for enterprises. Managers need to observe the trends and develop strategies to take advantage of the new technologies.

## Customer Relationship Management (CRM)[34]

Customers are the reason for an organization's existence. Therefore, to be successful, enterprises need to focus on the needs of their customers. Customer Relationship Management (CRM) addresses this need. Companies are also faced with the need for a system that reduces costs and coordinates sales and marketing and service efforts to provide a positive experience for their customers, such as handling complaints. It is through the CRM system that data is collected on customers in a centralized database.

**CRM** means promoting the interactions between the customer and the organization by collecting, analyzing, and using the information to better serve the client.

There is no agreed definition of customer relationship management. In broad terms, CRM means promoting the interactions between the customer and the organization by collecting, analyzing, and using the information to better serve the client. CRM is not new, but it has gone through various overlapping stages. The beginning of CRM probably can be traced to Siebel Systems Inc. in 1993. In the 1990s, CRM approaches were accompanied by a number of failures. At stage 1, the emphasis was on marketing processes; stage 2 focused on customer relationships; stage 3 utilized the Internet for reevaluating the processes, redesigning systems, and self-service. It is in stage 4 that more attention is given to the specific needs of the customers.

Professor Raab and his colleagues view CRM as being based on three pillars: technology, organization, and personnel which are the foundation of customer orientation, customer satisfaction, customer retention, and customer profitability.[35]

Another way of looking at the process of CRM is that an effective use of its pillars of personnel, technology, and organization lead to customer orientation, product quality, customer satisfaction, customer retention, customer value and eventually to company success.

CRM is used by many organizations. At Marriott, for example, it is used to boost sales, manage the Marriott Rewards program, and for the Broadsystem that expands the company's marketing program. The travel industry has extensively used programs for managing the relationships with its customers. For example, CRM has been employed by companies such as Southwest Airlines, JetBlue, Best Western, British Airways, Delta, American Airlines, Alaska Airlines, Walt Disney, Travelocity, and Expedia.

There are also concerns and limitations of CRM. For one, large investments are required for building and maintaining the system. Hardware and software are required and so is the costly training of the system's users. Customers are also concerned about their privacy and that the collected information about them could be misused.

Clearly, CRM is not a cure-all for solving all the problems in the relationships between an organization and it customers. However, certain steps can help to make the system succeed. Careful planning is certainly necessary. Also, since the installation of the systems requires organizational changes, people need to be prepared for the cultural adjustment. In many cases, it might not be wise to begin with a costly comprehensive system. Instead a company may start with a pilot program and incrementally enlarge the system. At any rate, for companies to remain competitive or better to achieve a competitive edge, they may utilize CRM for systematically staying in contact with their customers who are the reason for the organization's success.

## SUMMARY

A variety of tools and techniques have been used to help managers control. These techniques are generally, in the first instance, tools for planning, and they illustrate the fact that controls must reflect plans. Some of these tools have long been used by managers; others are refinements. One of the older control devices is the budget. Budgeting is the formulation of plans for a given future period in numerical terms. There are also dangers in budgeting. Budgeting is made much more precise by zero-base budgeting, in which programs are divided into "packages." The costs for each package are calculated from a base of zero. In order to make budgetary control effective in practice, managers must always realize that budgets are tools and are not intended to replace managing. Among the traditional nonbudgetary control devices are statistical data and their analyses, special reports and analyses, the operational audit, and personal observation.

One of the techniques of planning and control is the time–event network analysis. The Program Evaluation and Review Technique (PERT) is a refinement of the original Gantt chart, which was designed to show, in bar-chart form, the various tasks that must be done, and when, in order to accomplish a program. PERT is also a refinement of milestone budgeting, in which the tasks that have to be done are broken down into identifiable and controllable pieces called milestones. When milestones are connected to form a network and the time required to complete each milestone is identified, the result is a PERT/time–event network. Using the sequences of events and the times required for them, one can determine the critical path, which is the sequence that takes the longest time and has zero (or the least) slack time.

The management information system is a formal system of gathering, integrating, comparing, analyzing, and dispersing information internal and external to the enterprise in a timely, effective, and efficient manner to support managers in their work.

Computers (mainframes, minicomputers, and microcomputers) are now extensively used. Their impact on managers at various organizational levels differs. Information technology provides many challenges. Some managers still resist using computers, but speech recognition devices will encourage computer use. Computers have also contributed to telecommuting, allowing people to work from home at a computer that is linked to a company's mainframe computer. Increasingly, computer networks are installed to link workstations with each other, with larger computers, and with peripheral equipment.

The Internet revolution brings exciting new opportunities for business and personal life. It is changing how business is conducted. The relationships with suppliers and customers are changing dramatically. The four kinds of electronic business transactions are shown in Figure 19.3. There is now a trend toward wireless communications and m-commerce, especially in Japan and Europe. Customer Relationship Management (CRM) aims at serving the needs of its clients.

## KEY IDEAS AND CONCEPTS FOR REVIEW

- ✔ Budgeting
- ✔ Types of budgets
- ✔ Budgeting problems
- ✔ Zero-base budgeting
- ✔ Nonbudgetary control devices
- ✔ Gantt chart
- ✔ Milestone budgeting
- ✔ Program Evaluation and Review Technique (PERT), critical path
- ✔ Information technology
- ✔ Management information system
- ✔ Types of computers
- ✔ Impact of computers on managers
- ✔ Application of microcomputers
- ✔ Speech recognition devices
- ✔ Telecommuting
- ✔ Computer networks
- ✔ Internet
- ✔ Groupware
- ✔ Information security
- ✔ e-Commerce: B2C, C2B, C2C, B2B
- ✔ m-Commerce and wireless communications
- ✔ Customer Relationship Management

## FOR DISCUSSION

1. The techniques of control appear to be as much techniques of planning as they are of control. In what ways is this true? Why would you expect it to be so?
2. If you were going to institute a program of special control reports and analyses for a top manager, how would you go about it?
3. PERT is a management invention that takes basic principles and knowledge and, through design to get a desired result, comes up with a useful technique of planning and control. Analyze PERT with this in mind.
4. Give examples of how information technology has affected you.
5. Why do you think computers impact on managers at various organizational levels differently?
6. How will e-commerce affect you in the future on buying or selling of goods and services?
7. How do you feel about your personal data being stored in the customer relationship management system of the organization with which you are doing business?

## EXERCISES/ACTION STEPS

1. Prepare a budget for your studies at the university. What are the advantages in preparing a budget? What are some problems?
2. Select an organization that you know and show how it uses computers or conducts e-commerce.

## INTERNET RESEARCH

1. B2C, C2B, C2C, and B2B have been widely used phrases in the Internet economy. Search for these terms on the Internet to find out how these concepts are applied by organizations.
2. Search the Internet for the term "management information system," and identify the various applications and usages of this system.

## International Case — Amazon.com—America's Biggest Online Retailer[36]

Amazon, the largest online retail company in the United States, was founded by Jeff Bezos in 1995. The name Amazon was chosen in reference to the Amazon River, one of the largest rivers in the world. The company started as an online bookstore, but later added CDs, DVDs, software, electronics, apparels, toys, food, and a variety of other products. Besides operating in the United States, the company also has websites in Austria, Canada, China, France, Germany, Italy, Japan, and the United Kingdom. Over the years, Amazon made many acquisitions such as Bookpages.co.uk, an online book company, BookSurge, a print-on-demand firm, Shophop, a retailer of designer clothing and women's accessories, and Zappos, an online retailer for shoes and apparel.

Amazon also has rather interesting partnerships with other companies such as Target, Timex, Lacoste, and many others.

One well-known product is Kindle which is a wireless e-book reader but does much more than reading books. It allows for downloading newspapers and magazines, blogs, and other media. There are several Kindle products available, ranging from the mainline to the large-screen DX line. The DX is especially suitable for reading textbooks or magazines. Kindle books can be downloaded on a computer. In 2011 Amazon sold more Kindle books than printed books.[37] Using the "Kindle for PC" program allows for purchases using a personal computer or even an iPhone or iPod Touch.

Many of Amazon's sales are derived from third-party sellers, called "Amazon Associates" and third party sellers. The offices, called fulfillment centers, are located throughout North America, Europe, and Asia. They are often near airports which enhances speedy delivery.

Amazon has its critics and complaints ranging from patent infringement, price discrimination, anti-union efforts, and libel, to the publication of questionable books. One current issue pertains to the collection of U.S. sales taxes on the sales of its products. The tax is collected in only a few states in the United States. Brick-and-mortar stores, on the other hand, have to collect sales taxes and they consider the Amazon.com advantage as being anti-competitive.

Late in 2011, Amazon unveiled the Kindle Fire tablet computer which some consider a competition to the iPad. The Kindle price of $199 is substantially lower than the iPad 2 which starts at $499. Therefore, the Kindle Fire tablet may be appealing to those consumers looking for a less expensive alternative to the iPad 2. Magazine publishers welcome the Kindle Fire as an alternative to the iPad. Amazon has the advantage of Apple that it not only sells music, videos, books and other items, but it also sells toys, clothes, appliances, and many other items—an advantage for Amazon.

Amazon is a success story. The company that had a humble beginning in 1995 has grown to become the biggest online retailer in the United States.

**Questions**

1. Why was Amazon successful?
2. Would you buy an item on Amazon.com? Why or why not?
3. Do you prefer reading a book, including a textbook, on the Kindle or do you prefer the printed text? Give your reasons.
4. Do you think that the Kindle Fire tablet computer is a challenge to Apple's iPad? Why or why not?

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# 20 Productivity, Operations Management, and Total Quality Management

## CHAPTER OBJECTIVES

After studying this chapter, you should be able to:

- Identify the nature of productivity issues and suggest ways to improve effectiveness and efficiency
- Describe production and operations management as an applied case of managerial planning and control
- Understand the operations management system
- Discuss the tools and techniques for improving productivity
- Recognize the importance of quality, the nature of a variety of techniques for improving quality, and lean manufacturing
- Distinguish between supply chain management and value chain management, although the terms are sometimes used interchangeably

In a real sense, this whole book is about the improvement of productivity. But this important topic will receive special attention in this chapter, with an emphasis on the micro level of production and operations management.*

## PRODUCTIVITY PROBLEMS AND MEASUREMENT

Undoubtedly, productivity is one of the major concerns of managers in the 21st century. This is a concern in many parts of the world. Even Japan, which is admired for productivity improvement, is now concerned about remaining competitive in the world market.

*Additional topics in production and operations management are discussed in other parts of the book. See, for example, Chapter 6 for various aspects of decision-making, Chapter 11 for job design, and Chapter 19 for management information systems and different kinds of control techniques.

## Productivity Problems

Productivity implies measurement, which in turn is an essential step in the control process. Although there is general agreement about the need for improving productivity, there is little consensus about the fundamental causes of the problem and what to do about them. The blame has been assigned to various factors. Some people place it on the greater proportion of less-skilled workers with respect to the total labor force, but others disagree. There are those who see the cutback in research and the emphasis on immediate results as the main culprit. Another reason given for the productivity dilemma is the growing affluence of people, which makes them less ambitious. Still others cite the breakdown in family structure, workers' attitudes, and government policies and regulations. Increasingly, attention shifts to management as the cause of the problem—as well as the solution, which is the focus of this book.

## Measurement of Productivity of Knowledge Workers

**Productivity** The output—input ratio within a time period with due consideration for quality.

As defined in Chapter 1, **productivity** is the output–input ratio within a time period with due consideration for quality. This definition can be applied to the productivity of organizations, managers, staff personnel, and other workers. Measurement of skill work is relatively easy, but it becomes more difficult for work that requires knowledge. The difference between the two kinds of work is the relative use of knowledge and skills. Thus, a person on the production line would be considered a skill worker, while the assistant to the manager with planning as his or her main function would be a knowledge worker. Managers, engineers, and programmers are knowledge workers because the relative amount of their work does not consist of utilizing skills, as would be the case for bricklayers, mechanics, and butchers. The job title, however, cannot be the sole guide for making distinctions. The owner of a gas station may schedule the day's tasks, determine priorities, and direct subordinates, but he or she may also change brakes, adjust the carburetor, or realign the front wheels on a car.

It is clear that, in general, the productivity of the knowledge worker is more difficult to measure than that of the skill worker. (Note also that worker productivity measurement is somewhat artificial because it often ignores the cost of capital.) One difficulty in measuring the productivity of knowledge workers is that some outputs are really activities that help achieve end results. Thus, the engineer contributes indirectly to the final product. Another difficulty is that knowledge workers often assist other organizational units. The advertising manager's efforts should improve sales, but it is hard to say for sure what the exact contribution is. Still another difficulty is that the quality of knowledge workers' outputs is often hard to measure. The effects of a strategic decision, for example, may not be evident for several years, and even then the success or failure of the new strategic direction may depend on many external forces beyond the control of the manager.

It is evident that productivity improvement is achieved by the good management practices advocated throughout this book. But the discussion will now turn to the specific area of production and operations management, where measurement is relatively easy and which consequently has been the focus of productivity improvement programs in the past.

## PRODUCTION AND OPERATIONS MANAGEMENT: MANUFACTURING AND SERVICE

One of the major areas in any kind of enterprise whether business, government, or others, is the production and operations management. It is also the area where managing as a scientifically based art got its start. The contributions of such management pioneers as Frederick Taylor, Henry Gantt, and Frank Gilbreth, to mention only a few, indicate that their interest was largely in improving productivity and manufacturing products most efficiently while still recognizing, as they did, the importance of the human factor as an indispensable input.

**Production management** deals with activities necessary to manufacture products.

**Operations management** deals with activities necessary to produce and deliver a service as well as a physical product.

In the past, **production management** was the term used to refer to those activities necessary to manufacture products. However, in recent years, the area has been generally expanded to include such activities as purchasing, warehousing, transportation, and other operations from the procurement of raw materials through various activities until a product is available to the buyer. The term **operations management** refers to activities necessary to produce and deliver a service as well as a physical product.

There are of course other essential activities undertaken by a typical enterprise. These activities often include research and development, engineering, marketing and sales, accounting, and finance. This chapter deals only with what has come to be called operations management or production management or, often, production and operations management. It should be pointed out that this is not the same thing as operational management theory. Operational management theory is the study of the practice (managing) which that theory or science is designed to underpin.

Service organizations do not produce a physical output but provide some service as an output. For instance, the input of students with limited knowledge, skills, and attitudes becomes enriched and transformed through attending lectures, doing case analyses, participating in exercises, and engaging in other activities that will result in the output of educated students, which is documented by a degree. Other examples of service providers are hospitals, doctors, consultants, airlines, restaurants, musicians, and the great variety of retail stores.

**LEADERSHIP PERSPECTIVE**

### Jack Welch: Leading GE's Transformation from Products to Services[1]

www.ge.com

General Electric (GE) is known for a variety of products, including medical imaging equipment such as CAT scanners and magnetic resonance imagers. Now it has expanded its business into servicing not only its own sophisticated products but even those of its competitors. GE's then chief executive, Jack Welch, said: "We are in the services business to expand our pie."

GE offers services ranging from health care to utilities. Thus, it provides such services as maintenance of medical systems, maintenance and overhaul of aircraft en-

gines, operation and maintenance of utility power plants, locomotive maintenance, servicing of electronic tracking devices for railroads, and even providing help in running corporate computer networks. The result is that almost 60 percent of GE's profits come from services. Jack Welch would even like it to be 80 percent. The new direction in U.S. industry may be a trend toward services so that products are only one aspect of the business.

## QUALITY MEASUREMENT IN THE INFORMATION AGE[2]

In the past, the concepts of quality were mostly applied to products, such as cars or refrigerators. With the increase in service companies, quality concepts must also be applied in those firms. This means such things as the measurement of expectations, experiences, and emotions. For example, how do customers feel waiting in line in a restaurant or at Disneyland rides, or waiting on the telephone for help?

Quality in the information age takes on new dimensions. Software package quality does not only include reliability but also technical support services, compatibility, upgradability of the software, and the integration of the information infrastructure not only with the company but also with its suppliers and customers. Wal-Mart, for example, gains a competitive edge through supply chain management. Focusing on the quality of the information infrastructure is critical for company success in the new information age.

## THE OPERATIONS MANAGEMENT SYSTEM

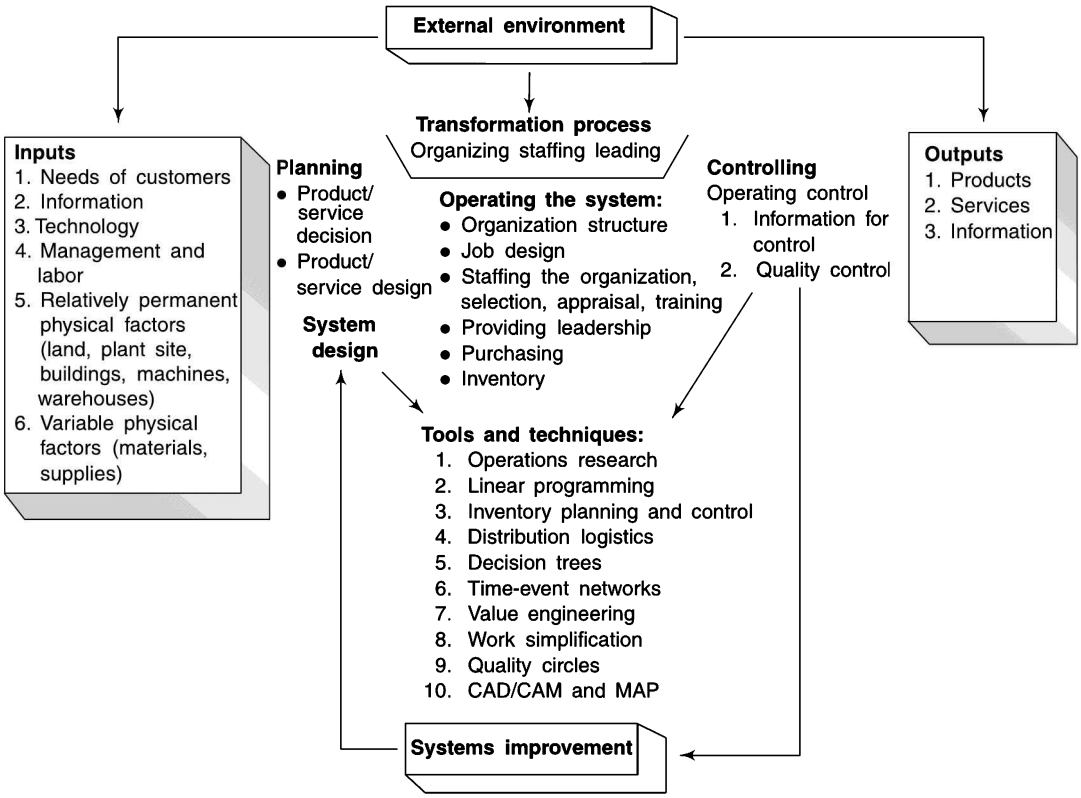
Operations management has to be seen as a system. Figure 20.1 gives an overview of the operations function. In the operations management model, the *inputs* include needs of customers, information, technology, management and labor, fixed assets, and variable assets that are relevant to the transformation process. Managers and workers use the information and physical factors to produce outputs. Some physical elements, such as land, plant site, buildings, machines, and warehouses, are relatively permanent. Other physical elements, such as materials and supplies, are consumed in the process of producing outputs. The *transformation process* incorporates planning, operating, and controlling the system. There are many tools and techniques available to facilitate the transformation process. The model also reflects a constant concern with *system improvement*. *Outputs* consist of products and services and may even be information, such as that provided by a consulting organization.

The last part of the model shows that operations are influenced by *external factors*, such as safety regulations or fair labor practices. Since the external environment is discussed elsewhere in this book (especially in Chapter 2 and Part 2), it will not be expanded on here; the important point is that operations management must be an open system interacting with its surroundings.

The operations management model (Figure 20.1) serves as a framework for the discussions that follow. There is a close relationship between this model and the one introduced in Chapter 1 (Figure 1.6), since this operations model may be regarded as a subsystem of a total management system. Examples of operations systems with

**Figure 20.1**

**Operations Management System.**




inputs, transformation (sometimes also called process), and outputs are presented in Table 20.1.

**Table 20.1** Examples of Operations Systems

| *Inputs* | *Transformation* | *Outputs* |
|---|---|---|
| ■ Plant, factory machines, people, materials | Assembling bicycles | Completed bicycles |
| ■ Students with limited knowledge, skills, and attitudes | Lectures, cases, experiential exercises, term papers | Students with enhanced knowledge, skills, and attitudes |
| ■ Client problem | Consulting: data collection and analysis, evaluation of alternatives, selection of an alternative, recommendation | Consultant's report recommending course of action |

## Planning Operations

The objectives, premises, and strategies of an enterprise (discussed in Part 2) determine the search for and the selection of a product or service as its output. In this discussion, the production of physical products is emphasized, but the concepts can also be applied to the provision of services. After an end product has been selected, the specifications are determined and the technological feasibility of producing it is considered. The design of an operations system requires decisions concerning the location of facilities, the process to be used, the quantity to be produced, and the quality of the product.

**Special interests in a product decision** One of the basic decisions an enterprise makes is selecting a product or products it intends to produce and market. This requires gathering product ideas that will satisfy the needs of customers and contribute to the goals of the enterprise while being consistent with the strategy of the firm. In a product decision, the various interests of functional managers must be considered. The production manager may want a product that can be produced without difficulty, at a reasonable cost, and with long production runs. Engineers may share many of these aims, but they are often looking for engineering sophistication rather than ways of producing the product at a reasonable cost. The sales or marketing manager's interest is likely to be the needs of customers, and his or her aim is to increase the sales of products through ready availability and competitive prices. Moreover, the sales manager may want to offer a broad product line without considering engineering, production, transportation, and warehousing costs and the problems involved. The finance manager's concerns are likely to be costs and profits, high return on investment, and low financial risks. The divergent interests of these functionally oriented managers and professionals influence what products will be produced and marketed, but it is the general manager who has to integrate the various interests and balance revenues with costs, profits with risks, and long-term with short-term growth.

**Product and production design**[3] The design of a product and its production requires a number of activities. The following steps have often been suggested:

1. Create product ideas by examining consumer needs and screening the various alternatives.
2. Select the product on the basis of various considerations, including data from market and economic analyses, and make a general feasibility study.
3. Prepare a preliminary design by evaluating various alternatives, taking into consideration reliability, quality, and maintenance requirements.
4. Reach a final decision by developing, testing, and simulating the processes to see if they work.
5. Decide whether the enterprise's current facilities are adequate or if new or modified facilities are required.
6. Select the process for producing the product, and consider the technology and the methods available.
7. After the product is designed, prepare the layout of the facilities to be used, plan the system of production, and schedule the various tasks that must be done.

**Systems design** In producing a product, several basic kinds of production layouts can be considered. One alternative is to arrange the layout according to the sequence of *production or assembly* of the product. For example, a truck assembly line may be arranged such that first the preassembled front and rear axles are attached to the frame, followed by the installation of the steering, the engine, and the transmission. Then the brake lines and electrical cables are connected, and other parts are assembled and painted. Finally, the truck is road-tested.

A second alternative is to lay out the production system according to the *process* employed. In a hospital, for example, specific steps are likely to be followed: admission of the patient, treatment (which usually involves specific subprocesses), billing for service, and discharge. This may be followed by post-hospitalization treatment.

In a third kind (sometimes called *fixed position* layout), the product stays in one place for assembly. This layout is used for the assembly of extremely large and bulky items, such as printing presses, large strip-mining machines, and ships.

The fourth kind of layout is determined by the nature of the *project*. Building a bridge or tunnel is normally a one-time project designed to fit specific geographic requirements.

In the fifth kind, the layout is designed to facilitate the *sale* of products. In a supermarket, basic food items, such as dairy products, are normally located away from the checkout counters. This causes customers to walk through the long aisles and, it is hoped, select other items on the way to the dairy section.

A sixth basic approach is to design the process so that it facilitates *storage or movement* of products. Storage space is costly, and an effective and efficient design can keep storage costs low. Also, to reach an item, it should not be necessary to move many other items.

## Operating the System

After a product has been selected and the system for producing it has been designed and built, the next major step is to operate the system. This requires setting up an organization structure, staffing the positions, and training people. Managers are needed who can provide the supervision and leadership to carry out activities necessary to produce desired products or provide services. Other activities such as purchasing and maintaining the inventory are also required in operating the system. The aim is to obtain the best productivity ratio within a time period with due consideration for quality.

**INTERNATIONAL PERSPECTIVE**

### Volkswagen's High Operating Costs—Should VW Refocus Its Strategy?[4]

Volkswagen, VW, once known for low prices and good quality, faced a strategic shakeup in 2005 when it was loosing money. Factory wages, among the highest

in the world, helped to make VW uncompetitive. The VW manufacturing wage of 34 Euros (about US$41) compared unfavorably with the 25.49 Euros in the U.S. as reported by the German Automotive Industry Association. At the same time, Germany had over 11 percent unemployment rate, the highest in the post-World War II period. In addition, there were alleged bribery charges against top officials who may have paid labor leaders for cooperating in labor contract discussions. VW plants in Europe worked only at 81 percent of capacity, much worse than its competitors Toyota and Renault that operated at over 90 percent capacity. With an aging model line, poor financial performance, and alleged bribery charges, the CEO Bern Pischetsrieder hired the US-educated Wolfgang Bernhard who worked briefly with DaimlerChrysler, the consulting firm of McKinsey, and Mercedes.

Mr. Bernhard's task was to engineer a turnaround strategy which included cost-reduction, quality improvement, focusing on value offered to the mass market, and reducing the emphasis on competing in the high-end quality brands such as Mercedes. To accomplish these aims, Bernhard initiated a program that linked bonuses to quality improvement. Moreover, engineers were instructed to simplify the complexity of products.

www.vw.com

Volkswagen started with a low-cost, good quality car image, then attempted to move into the high-end class, and now is moving closer to the high value market. Operation realities may require a reevaluation of the strategy.

## Controlling Operations with Emphasis on Information Systems

Controlling operations, as in any other case of managerial control, requires setting performance criteria, measuring performance against them, and taking actions to correct undesirable deviations. Thus, one can control production, product quality and reliability levels, inventory levels, and workforce performance. A number of tools and techniques have been developed to do this. Because their application extends beyond operations or production, they have been discussed earlier. Some, however, are important to operations; examined here is the role of information systems in operations control.

Information systems, which have been available for several years, integrate information on virtually an instantaneous basis, thereby reducing considerably the delays that usually impede effective control. With the development of computer hardware and software, it is now possible for virtually any measurable data to be reported as events occur. Systems are available for quickly and systematically collecting data bearing on total operation, for keeping these data readily available, and for reporting without delay the status of any of a large number of projects at any instant. They are thus primarily information systems designed to provide effective planning and control.

**INTERNATIONAL PERSPECTIVE**

## How an Information System Facilitates Operations

Applied widely now to purchasing, storage, manufacturing, and shipping, information systems may operate through dispatch stations and input centers located throughout a plant. At the dispatch centers, events are recorded as they occur, and the information is dispatched immediately to a computer. For example, when a worker finishes an assigned task on the assembly of a product, the work-order time card is put into a transactor, which electrically transmits to a computer the information that item X has passed through a certain process, has accumulated *y* hours of labor, and may or may not be on schedule, as well as other pertinent data. The input centers are equipped to originate information needed for a production plan automatically from programmed instructions, purchase orders, shop orders, and other authorizations. These data are fed into a computer and compared against plans, which are used as standards against which actual operations can be compared.

In addition to providing fast entry, comparison, and retrieval of information, such an integrated operations control system furnishes needed information for planning programs in such areas as purchasing, production, and inventory control. Moreover, it permits almost instantaneous comparison of results with plans, pinpointing where they differ and providing a regular (daily or more often, if needed) system of reports on deviations from plans, such as items that are behind schedule or costs that are running above budget.

Other planning, control, and information systems have been developed to reflect quickly the interaction between production and distribution operations and such key financial measures as cost, profit, and cash flow. Companies with real-time computer models can give operating managers virtually instant analysis of such what-if questions as the effects of reducing or raising output, the impact of a decline in demand, and the sensitivity of the system to labor-cost increases, price changes, and new equipment additions. To be sure, system models, simulating actual operations and their impact on financial factors, are primarily planning tools; but so are most control techniques. By making possible exceptionally quick responses to the many what-if questions of operating managers, system models can greatly reduce the time elapsed in correcting for deviations from plans and can materially improve control.

These and other systems that use the technology of fast computation clearly promise to hasten the day when planning of all the areas of production can be more precise and controlling more effective. The drawback is not cost; rather, it is the failure of managers to spend time and mental effort conceptualizing the system and its relationships or to see that someone else in the organization does so. Nevertheless, as pointed out in Chapter 18, fast information availability can never provide true real-time control of the time delay in any feedback system. Only a feedforward approach can overcome these delays.

# TOOLS AND TECHNIQUES FOR IMPROVING PRODUCTIVITY

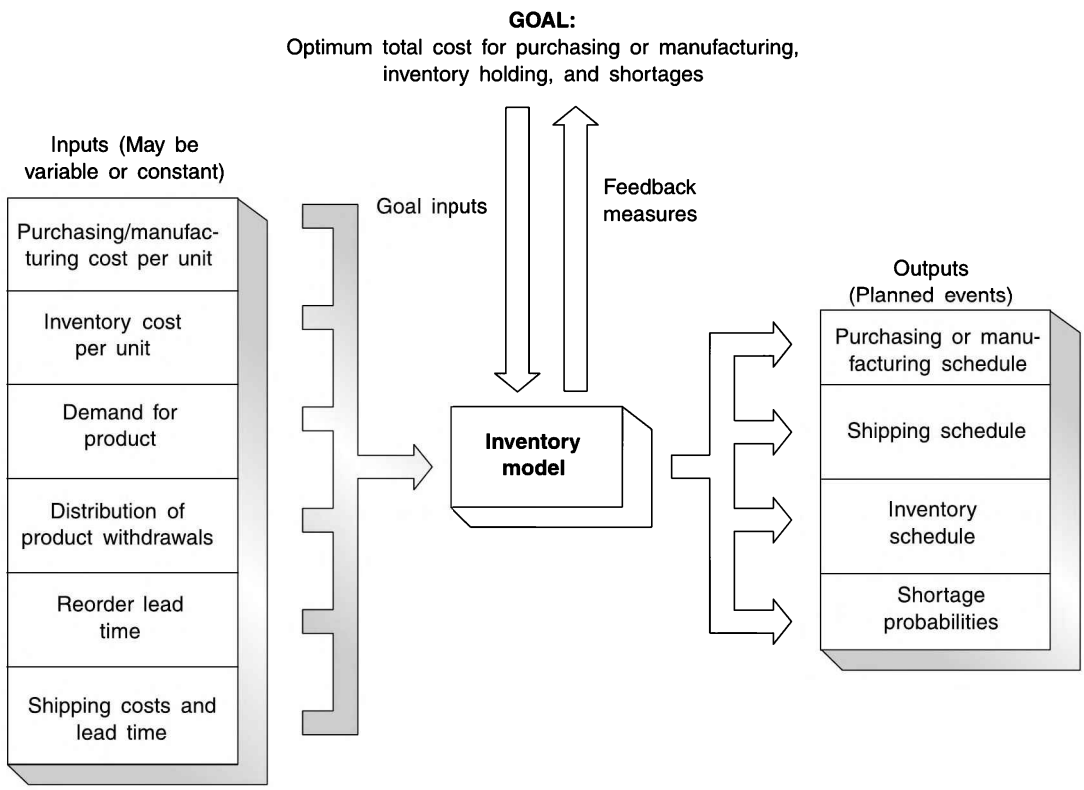
There are many tools and techniques available for improving manufacturing and service operations. They include inventory planning and control, the just-in-time inventory system, outsourcing, operations research, value engineering, work simplification, quality circles, total quality management, lean manufacturing, computer-aided design, and computer-aided manufacturing.

## Inventory Planning and Control

In the history of operations research, perhaps more attention has been directed to inventory control than to any other practical area of operations. The essential systems relationships can be seen as a little "black box," as depicted in Figure 20.2.

**Figure 20.1**

**Inventory Control Model.**



In mathematical form, these conceptual relationships are expressed by the equation

$$Q_e = \sqrt{\frac{2DS}{H}}$$

where $Q_e$ = economic order quantity
$D$ = demand per year
$S$ = setup costs
$H$ = inventory-holding (carrying) cost per item per year

The model in Figure 20.2 illustrates several things. It forces consideration of the goals desired and of the need for placing values on outputs and inputs. It also furnishes a manager with the basis for plans and with standards by which to measure performance. However, with all its advantages, this is a subsystem and does not incorporate other subsystems, such as production planning, distribution planning, and sales planning.

The **Economic Order Quantity (EOQ) approach** for determining inventory levels has been used by firms for many years. It works reasonably well for finding order quantities when demand is predictable and fairly constant throughout the year (i.e., there are no seasonable patterns). However, for determining the inventory levels of parts and materials used for some production processes, it does not work well. For example, poor quality of parts may increase the demand for these production inputs. Thus, demand is likely to be intermittent, resulting in inventory shortages at some times and excesses at other times. Firms determining inventory levels in these manufacturing settings have found that inventory control approaches such as material requirement planning and *kanban* (just-in-time) systems perform better than EOQ.

## Just-in-Time Inventory (JIT) System

**Just-in-time inventory system** The supplier delivers the components and parts to the production line only when needed and "just in time" to be assembled.

One reason for Japan's high manufacturing productivity is the cost reduction it achieves through its **just-in-time inventory method**. In this system, the supplier delivers the components and parts to the production line only when needed and "just in time" to be assembled. Other names for this or very similar methods are **zero inventory** and **stockless production**.

For this method to work, a number of requirements must be fulfilled: First, the quality of the parts must be very high; a defective part could hold up the assembly line. Second, there must be dependable relationships and smooth cooperation with suppliers. Third, the suppliers ideally should be located near the company, with dependable transportation available.

## Outsourcing[5]

**Outsourcing** The contracting of production and operations to outside vendors that have expertise in specific areas.

One recent trend in the United States and Europe is **outsourcing**. This means that production and operations are contracted to outside vendors that have expertise in specific areas. The aim may be to reduce costs by saving on personnel benefits, to reduce personnel, or to be able to reassign employees to other tasks that are more important. Thus, outsourcing is an important tool for expanding a company and for maintaining a competitive position. It enables a firm to focus on its core

www.nike.com

competencies and let outside companies do what they can do best. For example, Nike, Inc., the large supplier of athletic shoes, uses outsourcing for all of its shoe production, keeping only the production of the sophisticated Nike Air system.[6] It also outsources advertising. By focusing on what it can do best, Nike has accomplished an extraordinary growth rate.

Other reasons for outsourcing include gaining access to the best sources available worldwide, sharing of risks between the firm and its suppliers, allocating capital to key success factors, outsourcing functions that are difficult to manage, or lacking the capability to carry out certain tasks.

Outsourcing may also serve as a strategic weapon. General Motors produces almost two-thirds of its parts in-house compared to Chrysler, which "insources" only about one-third of its parts. This gives Chrysler a competitive advantage because General Motors' in-house labor costs are substantially higher than suppliers'. Kodak found it more effective to outsource the day-to-day operation of its fleet of 10,000 vehicles. Similarly, Proctor & Gamble benefited from outsourcing its fleet operation, thus lowering its costs and improving the productivity of its sales force. Another function that may be outsourced is property management. Johnson Controls, for example, provides operation and maintenance services of buildings. The Presbyterian Medical Center in Philadelphia selected a single source for managing various tasks, including its food service, security, environmental services, central processing, transportation, maintenance, and engineering functions. Even Apple Computer has outsourced its system and network engineering as well as its telecommunication and help-desk services to a Canadian company. Outsourcing parts of the retailers' information system helped Britain's Woolworth's department store to reduce costs and gain skills.

It has been suggested that, before deciding on outsourcing, a business-practice reengineering* study should be conducted. The findings of this analysis may indicate which tasks are best suited for being continued within the company and which should be contracted out.

**LEADERSHIP PERSPECTIVE**

## Jack Welch: Leading GE's Contribution to India's Outsourcing Boom[7]

In 1989, few companies realized the outsourcing potential of India. When Jack Welch, then CEO of GE, visited India, he was told of India's need for developing high-tech sector. But it was after 1991, when the Indian government began reducing tariff barriers and export controls that India's economy started taking off. Mr. Welch's emphasis of cost-cutting made India's companies aware of their potential competitive strengths. GE's confidence in India's advantage encouraged other investments. GE itself opened the Technology Center in Bangalore providing thousands of employees to work on many projects, including developing new

*See the discussion on reengineering in Chapter 7.

refrigerators, jet engines, and many software projects. GE and other companies greatly contributed to India's economic growth of about seven percent in 2005.

www.ge.com

India's competitive strength becomes clear when comparing its labor rates with that in the U.S. For example, software programmers with two- to four-year experience earn approximately $10,000 annually in India while a U.S. counterpart makes some $62,000. Similarly, workers at India's call centers earn some $3,000 a year while a similar job in the U.S. pays $27,000. While today, many companies have located their service centers to India, only few people realize GE's contribution to India's outsourcing boom.

**Operations research** The application of scientific methods to the study of alternatives in a problem situation, with a view to obtaining a quantitative basis for arriving at a best solution.

## Operations Research

There are almost as many definitions of operations research as there are writers on the subject. For the purposes of this discussion, the most acceptable definition is that **operations research** is the application of scientific methods to the study of alternatives in a problem situation, with a view to obtaining a quantitative basis for arriving at a best solution. Thus, the emphasis is on scientific method, on the use of quantitative data, on goals, and on the determination of the best means of reaching the goals. In other words, operations research might be called "quantitative common sense."

**Value engineering** The process of analyzing the operations of the product or service, estimating the value of each operation, and attempting to improve that operation by trying to keep costs low at each step or part.

## Value Engineering

A product can be improved and its costs lowered through **value engineering**, which consists of analyzing the operations of the product or service, estimating the value of each operation, and attempting to improve that operation by trying to keep costs low at each step or part. The following specific steps are suggested:

1. Divide the product into parts and operations
2. Identify the costs for each part and operation
3. Identify the relative value of the contribution of each part to the final unit or product
4. Find a new approach for those items that appear to have a high cost and low value

**Work simplification** The process of obtaining workers' participation in simplifying their work.

## Work Simplification

Work methods can also be improved through **work simplification**, which is the process of obtaining the participation of workers in simplifying their work. Training sessions are conducted to teach concepts and principles of techniques such as time and motion studies, work-flow analyses, and the layout of the work situation.

**Quality Circle** A group of people from the same organizational area who meet regularly to solve problems they experience at work.

## Quality Circles

A quality control circle, or simply **Quality Circle** (QC), is a group of people from the same organizational area who meet regularly to solve problems they experience at

work. Members are trained in solving problems, in applying statistical quality control, and in working in groups. Usually a facilitator works with each group, which normally consists of 6 to 12 members. The QCs may meet four hours a month. Although QC members may receive recognition, they usually do not receive monetary rewards.

**INTERNATIONAL PERSPECTIVE**

## Quality Circles in Japan

For some time now, Japanese products have been well received. To a great extent, this has been due to the quality of the products, but this has not always been the case. In fact, in the 1950s and 1960s, many products made in Japan had the image of poor quality.

In order to compete in the world market, Japanese firms had to improve the quality of their products. The campaign to improve quality was initiated by regulatory action taken by the Japanese government. Shortly after World War II, the Japanese, realizing that their economic success depended on increasing exports, encouraged their government to set up a system of regulations mandating that all exporters submit to a government agency a sample of each product to be exported and that they meet demanding requirements for quality before receiving a permit to export.

The legislative drive for quality was supported by various management techniques encouraging or requiring product quality. One of the interesting techniques is QC, now in widespread use in Japan. At first, the focus was on the analysis of quality problems, but now other problems are also dealt with, such as cost reduction, workshop facilities improvement, safety, employee morale, pollution control, and employee education.

QCs evolved from suggestion programs. In both approaches, workers participate in solving work-related problems. Although in suggestion programs, the problems are usually quite specific, those dealt with by QCs are often more complex and require the involvement of several team members. The team consists primarily of rank-and-file workers and sometimes supervisors too. So-called efficiency experts are usually excluded from the team.

It is interesting to note that while the concept of quality control originated in the United States, the Japanese appear to have perfected it. More recently, American firms have "rediscovered" the importance of quality, as shown by advertisements for Chrysler and Ford automobiles. At any rate, there is no reason to doubt that QCs can be used by companies in the United States and other countries, which are now faced with a competitive situation in a world market that demands quality products.

INTERNATIONAL PERSPECTIVE

### Managing Quality for Success

Managing for quality requires leadership and hard work, and a continuous effort to achieve quality has paid off in many companies. BMW's chief executive attributes the company's success to tailoring the cars to the needs and desires of individual car buyers, which in turn is made possible by German craftsmanship. Proctor & Gamble uses quality management concepts to prevent pollution. Motorola's aim is to provide total customer satisfaction by bringing quality to the six-sigma level, which means to have not more than 3.4 defects per million components. Quality management also works in the service industry. At Nissan's Infiniti dealerships, people are trained to treat customers as honored guests. Quality is even used in the public sector. The Internal Revenue Service in Utah and state governments in Arkansas, Minnesota, and Oregon are trying to implement quality concepts in their operations. The approaches to improving quality and customer satisfaction vary—and so do the theories on which quality efforts are based. Some of the approaches advocated by quality proponents seem conflicting, creating a kind of a jungle.

## Total Quality Management[8]

**Total Quality Management (TQM)** Long-term commitment to continuous quality improvement, throughout the organization and with the active participation of all members at all levels, to meet and exceed customer expectations.

One popular approach to improving quality is called **Total Quality Management** (TQM). However, this term has various meanings. In general, TQM involves the organization's long-term commitment to the continuous improvement of quality, throughout the organization and with the active participation of all members at all levels, to meet and exceed customer expectations. This top-management-driven philosophy is considered a way of organizational life. In a sense, TQM is simply effective management.

Although the specific programs may vary, they usually require a careful analysis of customer needs, an assessment of the degree to which these needs are currently met, and a plan to fill the possible gap between the current and the desired situation. The success of this quality improvement approach often needs the cooperation of suppliers. Furthermore, to make the TQM program effective, top managers must be involved. They must provide a vision, reinforce values emphasizing quality, set quality goals, and deploy resources for the quality program. It is obvious that TQM demands a free flow of information—vertically, horizontally, and diagonally.

Training and development is very important for developing skills and for learning how to use tools and techniques such as statistical quality control. This continual effort for improving quality requires an environment that can be called a learning organization (see Chapter 13). Any quality improvement effort needs not only the support but also the involvement of management, from the top to the bottom, as well as nonmanagerial employees. People need to be empowered to initiate and implement the necessary changes. In the modern, interlocking organization, teamwork often becomes a prerequisite for an effective and efficient operation.

The quality improvement efforts need to be continuously monitored through ongoing data collection, evaluation, feedback, and improvement programs. TQM is not a one-time effort; instead, it is a continual, long-term endeavor that needs to be recognized, reinforced, and rewarded.

When done effectively, TQM should result in greater customer satisfaction, fewer defects and less waste, increased total productivity, reduced costs and improved profitability, and an environment in which quality has high priority.

A concern for quality should not be restricted to business. Principles of quality improvement also apply to government. The mayor of Madison, Wisconsin, demonstrated how quality programs can be implemented in city government. The first test came in the motor equipment division. After the initial success, a formal quality program was started citywide. What is surprising is that resistance to the program came not from unions or from the city council but from middle-level bureaucrats, who saw their power being eroded by the reduction in departmental barriers and by greater teamwork.

Quality management is of global concern. Therefore, the topics of the contributions by quality gurus, the Malcolm Baldrige National Quality Award, ISO 9000, and the European model for total quality management were discussed in chapter 3 on global management.

## Lean Manufacturing[9]

A study at the Massachusetts Institute of Technology that compared American, Japanese, and European car manufacturers showed that the Japanese gained a competitive advantage from the use of fewer workers, a shorter development time, lower inventories, fewer suppliers, less production space, and less investment to produce more models. The Japanese also had much shorter delivery time and were more productive than Americans and Europeans.

Some of the differences between traditional mass production and lean production managerial practices are listed in Table 20.2.

**Table 20.2** Mass Production versus Lean Production Managerial Practices

| *Mass production* | *Lean production* |
|---|---|
| ■ Sporadic and inconsistent improvements | ■ Continuous improvements (*kaizen*) with strategic breakthroughs |
| ■ Satisfied with "good enough" | ■ Aiming at zero defects |
| ■ High inventory acceptable | ■ Just-in-time inventory system |
| ■ "Me" management with emphasis on individual performance | ■ "We," or team, management |
| ■ Attitude that workers are the cause of poor quality | ■ Responsibility for problems rests on everyone, especially management |

http://www.pw.utc.com

It should be pointed out that, since the study was conducted, U.S. and European automobile manufacturers have adopted many of the lean production concepts and have become more productive. Lean thinking has even spread to nonautomotive

companies. Wal-Mart, a U.S. retail store, installed a just-in-time delivery system that works by letting suppliers connect to its computerized ordering system. Thus, suppliers can anticipate demands for their products. Pratt & Whitney, a U.S. aerospace firm, rearranged its work flow and thereby reduced its stock level by 70 percent and its unit costs by 20 percent.

## Computer-aided Techniques

Product design and manufacturing have been changing greatly in recent years, largely because of the application of computer technology. Computer-Aided Design (CAD) and Computer-Aided Manufacturing (CAM) are part of the cornerstones of the factory of the future.

CAD/CAM help engineers design products much more quickly than they could with the traditional paper-and-pencil approach. This will become increasingly important, since product life cycles are getting shorter. Capturing the market quickly is crucial in the very competitive environment. Moreover, firms can respond more rapidly to the requests of customers with specific requirements. The ultimate aim of many companies is computer-integrated manufacturing.

**INTERNATIONAL PERSPECTIVE**

### Merging the Production Systems of Daimler and Chrysler: A Mission Possible?[10]

www.daimlerchrysler.com

An important aim of merging Daimler with Chrysler was to obtain synergy, with resulting cost savings. However, it took quite some time to integrate the production systems, with Chrysler building more than three million cars a year primarily using mass production compared with Mercedes's one million cars designed for upscale customers. Chrysler emphasized the "push" approach, building cars for immediate delivery; whereas Mercedes practiced the "pull" system, building cars after orders are received, resulting in lower inventory costs but also in waiting lists ranging from four months to up to two years for certain models. The integration of the two companies took some time before the American and German engineers began trusting each other and sharing important information.

After a period of adjustment, however, the joint efforts are bearing fruit. Here are examples of how synergies have been achieved. Chrysler engineers took the Mercedes E-Class apart, studied it carefully, and adopted useful concepts. A similar process was employed by German engineers studying Chrysler's 300M model. The renowned NAG automatic gearbox, which is installed in most Mercedes cars, will be used in the next generation of Jeep Grand Cherokees and so may be a modified diesel engine. Chrysler is learning from Mercedes and vice versa. The new DaimlerChrysler was betting that the new collaboration will be the key to success in the very competitive market. However, the "marriage" of Daimler and Chrysler ended in a "divorce" in 2007 without realizing the full benefits of merging their production systems.

## SUPPLY CHAIN AND VALUE CHAIN MANAGEMENT[11]

**Supply Chain Management (SCM)** focuses on the sequence of getting raw materials and subassemblies through the manufacturing process economically.

**Value Chain Management (VCM)** involves analyzing every step in the process, ranging from the handling of raw materials to servicing end users, providing them with the greatest value at the lowest cost.

The terms supply chain and value chain management are sometimes used interchangeably. However, *Industry Week* points out that **Supply Chain Management (SCM)** focuses on the sequence of getting raw materials and subassemblies through the manufacturing process in an economical manner. **Value Chain Management (VCM)**, on the other hand, has a broader meaning and involves analyzing every step in the process, ranging from the handling of raw materials to servicing end users, providing them with the greatest value at the lowest cost. Therefore, some suggest that supply chain management focuses more on the internal process with an emphasis on efficient flow of resources, such as materials, while value chain management has similar aims with an additional concern for the external environment, such as the customer.

Professor Michael Porter popularized the **value chain process model**, which includes the primary activities of inbound logistics, operations, outbound logistics, marketing/sales, and service. The process is supported by the enterprise infrastructure, the management of human resources, technology, and procurement. Porter's model illustrates that value chain analysis has a broader orientation than supply chain management.

The **value chain process model** includes the primary activities of inbound logistics, operations, outbound logistics, marketing/sales, and service, with the process supported by the enterprise infrastructure, human resource management, technology, and procurement.

The goal of value chain management is to create a seamless chain of activities from the supplier, through the manufacturer, to the customer to meet and exceed his or her expectations. The process requires that all managerial functions of planning, organizing, staffing, leading, and controlling be carried out effectively and efficiently in a collaborative manner. In addition, technology is used to facilitate the entire process. The previous chapter on the various aspects of information technology discussed how this can be done. Value chain management may require a thorough analysis of the organizational process using reengineering concepts, which were discussed in chapter 7. Still another way of improving the value chain (especially for manufacturing) is to study and apply the operations management model shown in Figure 20.1.

**INTERNATIONAL PERSPECTIVE**

### The Interconnected Global Supply Chain Management

Thomas Friedman in his book *The World is Flat*, called the new supply chaining in the global market a "flattener".[12] This means, for example, that a company uses the lowest-priced products where ever they may be obtained, being China, India, or elsewhere. Robin Meredith used the term "disassembly line." I like to call this trend as the *interconnected global supply chain*. For example, clothing sold by J. C. Penney in America may include yarn produced in Korea, buttons from China,

and finished in Thailand.[13] Similarly, Apple's iPod may be produced in China, but containing chips that were invented in India. For many years, car companies have been using parts often produced in various countries. The aim is to obtain quality products at a low price. While the transportation costs partly offset the labor cost savings, the oil crisis, especially after 2008, will have a dramatic impact on the management of the supply chain; this is particularly true for heavier goods.

As we pointed out in this, book, management is one of the most important human activities. We introduced the systems approach to managing in which key managerial activities are grouped into the managerial functions of planning, organizing, staffing, leading, and controlling. These functions are essential for any organization. However, the application of the key managerial activities and the time spent for each function varies for each organizational level and the kind of enterprise – those aiming for profit and those not-for profit. Management is an art that uses the underlying sciences. The goal of all managers is the same — to create a surplus that benefits not only people and the organization, but also the nation and the society.

## SUMMARY

Productivity is a major concern of managers. It implies measurement, an essential step in the control process. The productivity measurement of skill workers is generally easier than that of knowledge workers such as managers. Yet, managerial productivity is very important, especially for organizations operating in a competitive environment.

Production management refers to those activities necessary to manufacture products; it may also include purchasing, warehousing, transportation, and other operations. Operations management has a similar meaning, referring to activities necessary to produce and deliver a service as well as a physical product. Quality measurement in the information age requires including factors other than reliability, such as the information infrastructure and the services of software suppliers.

The operations management system model includes inputs, the transformation process, outputs, and the feedback system. Selecting a product or service to produce requires consideration of customer needs, organizational goals, and the various interests of the functional managers of the enterprise. Planning and designing a product and its production involves several activities. Companies can choose from at least six kinds of production layouts catering for different production or operation needs. In order to operate the system, the managerial functions of organizing, staffing, and leading must be carried out effectively. Controlling operations requires an information system often supported by computers.

A variety of tools and techniques are available for making operations more productive, including inventory planning and control, the just-in-time inventory system, outsourcing, operations research, value engineering, work simplification, quality circles, total quality management, lean manufacturing, and a variety of computer-aided approaches. The concepts of supply chain management and value chain management are similar. However, the latter is more comprehensive and emphasizes the end user of the product or service.

## KEY IDEAS AND CONCEPTS FOR REVIEW

- ✔ Productivity problems and measurement
- ✔ Production management
- ✔ Operations management
- ✔ Quality in the information age
- ✔ Operations management system
- ✔ Steps in product and production design
- ✔ Production layouts
- ✔ Inventory planning and control
- ✔ Just-in-time inventory system
- ✔ Outsourcing
- ✔ Operations Research
- ✔ Value engineering
- ✔ Work simplification
- ✔ Quality Circle
- ✔ Total Quality Management
- ✔ Lean Manufacturing
- ✔ Computer-Aided Design
- ✔ Computer-Aided Manufacturing
- ✔ Supply Chain Management
- ✔ Value Chain Management
- ✔ Value chain process model

## FOR DISCUSSION

1. How would you measure the productivity of managers and other knowledge workers? Explain in detail.
2. Why is the field of production and operations management good to use as a case example of planning and control techniques? Why do you think this area was favored for analysis and productivity improvement by the pioneers in the field of management?
3. Distinguish between the planning and control techniques that are usually found only in production and operations management and those that are found useful in all areas of management. Why is there a distinction?
4. Explain the nature of and reasons for each step usually found in the development of a production and operations management program.
5. There are many typical layouts used in the design of a production program. Which one is ordinarily used for the manufacture of automobiles? Why?
6. Real-time information can be widely used in the area of production, but this does not solve the problem of control. Why?
7. What tools generally found in operations research have been widely used in production and operations management? Do they have anything in common? If so, what is it?
8. Why do you believe that quality control circles have been used so much in Japan?

## EXERCISES/ACTION STEPS

1. Draw the layout of your apartment or house, and indicate the pathways you take while doing your typical daily chores. Show any rearrangements you could make that would increase your effectiveness and personal productivity.
2. Interview several managers in a local company and ask how they measure the quality of their operations.

## INTERNET RESEARCH

1. Toyota was the first to adopt the Just-in-time (JIT) system. Dell applied the virtual network to JIT. Search the Internet for the term "just in time." Find out how JIT is used by enterprises.
2. Search the Internet for the term "total quality management." How is the approach used by organizations? Present your findings to the class.

## International Case Which Future Car Do You Want?[14]

Cars are changing continuously. Customers want safer, more fuel-efficient cars, and cars that "think" for the driver. To some extent, the futuristic car is already here – but many new features evolve rather quickly. Demand for gas-electric hybrids from Toyota and Honda is great as gas prices have soared. Hybrids from Toyota (Prius), Lexus (RX 40), Honda (Civic and Accord models), and Ford's SUV (Escape) are now more often seen on US highways. Companies such as DaimlerChrysler and other car makers are investing in hydrogen-fuel research. It appears, however, that this technology is still far away to be used in large numbers on passenger cars. The higher cost is only one factor in slowing the use of hydrogen-powered cars; safety and the need for a network of fuel stations are other considerations.

The most dramatic advances, however, can be expected in the use of electronic devices such as "active steering" using computer controlled small electric motors in the BMW, cruise controls that can identify when the driver gets too close to another vehicle. Increasingly, 2006 vehicles are equipped with satellite radios.

The traditional haggling over price at dealerships is also changing. Consumers now can find information not only about the technical details of cars, but also price information on the Internet.

**Questions**

1. What features would you be looking for in a new car?
2. List and prioritize the features important to you?
3. How important is safety, fuel economy, reliability, looks, entertainment, and others? Give the reason for your choices.

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