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Module
02

Organizational Environment

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Contents

Introduction

Organizations do not operate in a vacuous environment. Organizations operate in environment containing many components, ranging from competitors, technology, society, regulations, government, and others. If the organization fails to manage the environment, the organization can be destroyed by the environment. On the contrary, if the organization manages to 'master' the environment, the organization can progress to take advantage of environmental changes.

There are many examples of companies that have experienced a decline in performance for failing to anticipate environmental changes. In other words, the company has failed to manage its environment. On the contrary, there are many examples of companies that have successfully developed to take advantage of environmental changes. PT Pos Indonesia is an example of a company that has difficulty adapting to environmental changes.[1] During its prime, PT Pos Indonesia dominated all mail and package traffic in Indonesia. During festive, it was not unusual for PT Pos Indonesia employees to work overtime to process festive letters. With the development of internet technology in the 1990s, public behavior has changed. People would no longer send regular letters or conventional festive greeting letters. They use email to send letters, and SMS to send festive greetings. Nokia is another example of how failure in managing the environment can be fatal. Nokia was the company that dominated the cell phone market in the 2000s.[2] However, Nokia failed to anticipate the development of smartphones from Samsung and Apple. In the end, Nokia went bankrupt and was taken over by Microsoft. Several other companies have successfully utilized the environmental developments. Amazon is an example of companies that have successfully utilized the development of internet and digital technology. With this technology, Amazon developed an online bookstore, which replaced conventional bookstores. Amazon is also growing by selling other goods (other than books).

Organizations are also required to encourage a better life. So far, companies are known as profit seekers, at the expense of the world or the environment, if necessary. However, if the world is sacrificed in the long run, people and companies will also become victimized. In other words, the development or growth of the company is unsustainable. Therefore, the urge for companies to also help sustainable growth is highly encouraged. The following example illustrates the harm that industrialization has caused to the environment.[3] The United Nations (UN) has estimated that over the past 10 years, the damage associated with environmental change has reached $1.4 trillion. Within 40 years, the world experienced a 60% decline in natural life, both on land and sea. The additional forest destruction will reach 170 million hectares by 2030. Our seas are also in crisis. Humans are dumping plastic and chemical waste into the ocean and poisoning our food.

1 https://www.cnnindonesia.com/ekonomi/20190725093845-92-415313/melawan-senja-kala-pt-pos-indonesia, accessed on August 18, 2020

2 https://medium.com/multiplier-magazine/why-did-nokia-fail-81110d981787, accessed on August 18, 2020

3 https://www.weforum.org/agenda/2018/01/it-s-time-to-bring-our-planet-back-from-the-brink-together- now/

If such trends are not curbed, it isn't impossible that the earth will be ruined. Biodiversity will be significantly reduced in the short term, and the earth will experience a significant deterioration in quality, similar to a stock market crash. Therefore, companies are urged to maintain the quality of the earth. For example, currently, the efforts to reduce plastic waste are being intensified. Plastic bags in supermarkets are being eliminated. Mineral water served in plastic bottles is being replaced with glass. Plastic is a difficult waste to recycle. By reducing plastic waste, the environment will be cleaner and healthier. Other examples and efforts to improve the quality of the earth continue to be improved.

This module discusses the environment that is being faced by the organizations. It consists of three learning activities. Learning Activity 1 discusses an overview of the environment faced by the organizations. Learning Activity 2 and Learning Activity 3 discuss more specific organizational environmental issues, namely globalization as well as business ethics and corporate social responsibility. The last two issues are raised as they are highly relevant to the current environmental developments. Globalization shapes the development of the world today. In the era of globalization, the world is often described as one big village. In a village, information from one corner of the village will be quickly known by others in the other corner. Globalization is also characterized by the shrinking boundaries between countries. The smaller the boundaries between countries, the easier the flow of capital, products, information, between countries.

Business ethics and social responsibility are the next issues discussed in Learning Activity 3. Organizations are part of their environment. Therefore, in addition to achieving its own goals, an organization must also contribute to its environment. For example, a company is expected not only to seek profit, but also to contribute to society. Therefore, the company is also required to have social responsibility. Organizations are also required to behave ethically, by paying attention to the norms and regulations that exist in society.

After studying this module, you are expected to be able to explain the following.

1. Indirect Environment.
2. Direct Environment.
3. Organization - Environment Relationship Model.
4. Definition of Ethics.
5. Formation of Ethics.
6. Ethics in Organization.
7. Corporate Social Responsibility and its Controversies.
8. Definition of Globalization.
9. World Economic Conditions.
10. Multinational Corporation.

Learning Activity 1

Entrepreneurship

As a system, the organization will interact with its environment. If it wishes to survive, an organization must be able to adapt to its environment. The failure to adapt to the environment will be fatal. The organization will eventually perish.

The organizational environment can be divided into two types: external and internal. The external environment includes elements outside the organization that are relevant to the organization's activities. The organization obtains inputs from its environment (raw materials, employees), processes these inputs and provides outputs to the environment (products, information). The internal environment is an element within the organization, and not a part of the external environment. Some examples of the internal environment are employees, the board of commissioners, and shareholders.

The environment can also be divided into environments that have a direct influence on the organization and indirect ones. The environment that directly affects is often referred to as the task environment, while the environment that directly affects is referred to as the general environment. Examples of directly influential environments are competitors and employees. While an example of an indirect environment is the demographic conditions in which the organization is located. An environment that is not directly influential can transform into a direct influence. Therefore, organizations need to carefully observe their indirect environment.

The following figure illustrates the environment faced by the organization.

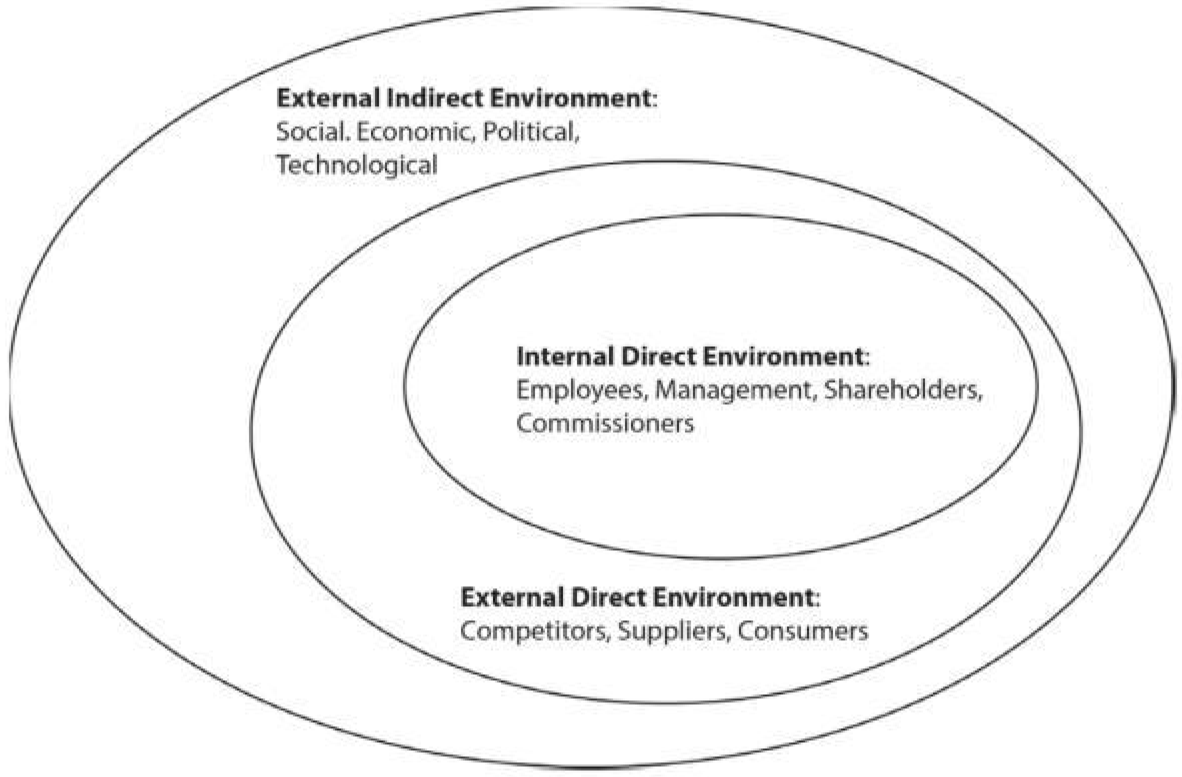

Figure 2.1
Organization Environment

The innermost environment is the environment within the organization itself. This environment consists of employees, management, commissioners, and shareholders. In the slightly outer circle, we have the work environment, which is the environment that has a direct influence on the organization. Some examples of task environment components are competitors, buyers, suppliers, financial institutions such as banks, government, labor unions, and media. The outermost environment is the general environment, which is the environment that indirectly affects the organization. Some examples of general environment components are social variables, technological variables, economic variables, and political variables.

The following sections will further explain these environments.

A. DIRECT ENVIRONMENT

The direct environment will affect the fate of the organization directly. Therefore, this environment is also referred to as stakeholders (parties that determine the fate of the organization). There are two types of direct environments: external and internal. Here are some examples of external direct environments, followed by examples of internal direct environments.

1. Internal Direct Environment

The internal direct environment is within the organization, and not a part of the external environment. The internal environment is part of the environment faced by specifically by individual managers, and not by the organization as a whole.

a. *Workers*

Before an employee works for an organization, he is a part of the external environment. But after working for the company he then becomes a part of the internal environment. Employees are the resources of the organization. The manager-employee relationship is quite a concern for management experts. If employees and organizations or managers have the same goals, the organization will run more effectively. But it seems that the concept is not easy to describe and implement. As a result, what often happens is a tug of war between the two. If the manager has a strong position then the manager will assert his interests at the expense of the employees' interests. Conversely, if the employee is too powerful then the employee will impose their interests at the expense of the manager's or the organization's. The first example, it is commonly heard that some management do not pay attention to their employees' working conditions and pay them a wage lower than the minimum rate The second example of the situation is the employees of General Motors (US car company) whose employees are members of a union. The union gives the employees a strong position and thus allows them to demand an increase in wages or benefits. One disadvantage of such situation is that labor costs may be too high, making it difficult to compete with imported car companies whose employees are not unionized.

In certain situations, management and employees can quickly unite.

For example, employees as well as managers of an American airline company were willing to take a pay cut so that the company could compete with other airlines by offering lower prices. Several alternatives were developed to align the interests of employees and management. One way is the ESOP (Employee Stock Ownership Plan) where employees, either directly or indirectly, own shares of the company they work for. If the employee works hard, and the company is profitable and the stock price rises, the employee will also be benefited as their wealth rises. Theoretically, this seems like a good model, although the details may not be straightforward. There are a number of possible problems: the perceived fairness of the distribution of shares, the possibility of free-riders, where some people may not work hard while others do, yet when the company succeeds, they enjoy the share of the success.

b. *Board of Commissioners*

The Board of Commissioners is commonly found in companies in the form of a Limited Liability Company (Ltd). The Board of Commissioners is appointed to represent the interests of shareholders. Their presence is even more necessary when shareholders are dispersed. A large company (Ltd) that sells its shares on the Stock Exchange will have thousands of shareholders. These shareholders will have a weak position with regard to management as they are unlikely to be able to meet and supervise management together. Even some important company secrets will not be revealed to them. To make supervision more effective, shareholders may appoint commissioners whose main task is to supervise management, ensuring that management works to achieve organizational goals. While ideally the BOC is independent from management, is able to represent the interests of shareholders, and has a strong position against management to force change where necessary, in certain situations, the BOC will not be as free as it should be. The BOC is often more dependent on the interests of management than on the interests of shareholders. In such situations supervision becomes less effective.

c. *Shareholders*

Shareholders provide their share capital to the company in the form of equity participation. They own the company and have rights and obligations attached to their ownership. Their rights include a share of the profits. Their obligations include bearing the company's risks. If the company goes bankrupt, they are the last to receive cash distributions from the sale of the company's assets in liquidation. If the company is a Limited Liability Company, their liability is limited to the capital invested. However, if the company is in the form of an individual or firm, their liabilities may extend to the personal wealth of the company owner.

d. *Stakeholder Network*

The aforementioned parties, which determine the fate of the company (stakeholders), form a network between stakeholders and the organization. For example, shareholders appoint the Board of Commissioners. Then, the BOC oversees the management's work as well as the organization's performance. Thus, the shareholders do not only influence the organization alone, but also through the formed stakeholder network. Organizations can leverage the stakeholder network to achieve organizational goals. For example, organizations in need of funds may contact financial institutions, then work together with shareholders.

Stakeholders can also play a dual role. Employees of the organization will be stakeholder with the role of an employee. If his child buys a product produced by the organization then he will be a stakeholder with the role of a consumer. In addition, different stakeholders can unite during a fight for the same thing. For example, if consumers want non-misleading product information, they can cooperate with the government. If the community wants environmentally clean products, it can cooperate with the government by asking the government to make regulations, and cooperate with consumers; consumers can boycott products that are not environmentally clean, even financial institutions or some of their shareholders refuse to buy shares of companies that are not environmentally clean.

The interests of stakeholders are not always the same, and often vary. For example, shareholders may want a high level of profit, while consumers want quality products at low prices. The surrounding community wants a clean environment, while employees desire a generous salary. Even the management itself has its own interests. In that case, managers are required to balance these opposing interests. Such balance will determine the fate of the organization.

2. Direct External Environment

a. Consumers

Consumers buy products produced by organizations with the intention of fulfilling their own needs. Consumers who need to eat will buy food products produced by food companies. In marketing language, consumers are often referred to as markets, which are defined as people who have needs, money, and a willingness to spend their money. Consumers, of course, determine the fate of an organization. If an organization fails to meet consumer needs, it will be abandoned by its consumers. Thus, companies must recognize changes in consumer tastes or needs.

Over time, in general, there is a tendency for consumers to become stronger in their relative position against companies as the level of public education becomes more advanced, hence consumers are increasingly aware of their rights. Organizations can no longer impose their will or fool their consumers. Competition is getting tougher, and consumers have many choices. However, for some business sectors (or industries), the organization's position remains quite strong. In markets that are monopolistic (either by nature or by regulation), the company's position is still stronger. In this situation, the organization is still required to act reasonably because the organization is bound by ethics and social responsibility as one day the consumer will become strong, which would not be good for companies that exploit consumers.

b. Suppliers

Suppliers are parties that provide inputs to the company. These inputs can be raw materials, semi-finished materials, employees, financial capital, information, or services needed by the organization. Raw materials are an example of staple material input. Organizations that are in need of employees will look for employees through employment service bureaus, or through universities that supply college graduates. If a factory machine breaks down, the organization can utilize machine repair services.

Just like consumers, managers need to pay attention to the development of suppliers. In certain sectors, suppliers have a fairly strong position, while in others, suppliers have a weak position to the company. A single supplier certainly has a stronger position compared to multiple suppliers, furthermore, the organization is no longer dependent on just one supplier. A close relationship with suppliers can improve the efficiency of the organization's activities. For example, the just-in-time inventory management that Japanese companies have successfully implemented, relies heavily on the close relationship between the organization and the supplier.

c. Competitors

Company organizations will compete for consumers with competitors. Competitors provide products that have the same function as the products produced by the organization to meet certain needs. Thus, we may infer that Garuda, Wing Air, Sriwijaya, Air Lion, and Bouraq are competing for airplane passengers. These organizations are in the same business sector. By a broad definition, competitors are not limited to the same business sector. The aviation business sector will compete with the land and sea transportation sectors for passengers. Failure to see competitors in other related sectors can sometimes be fatal to an organization's fate. For example, AMTRAK, a railroad company in the United States, was unable to anticipate the growing aviation sector. Passengers no longer take trains, and prefer to take airplanes.

A broader definition suggests that organizations will compete with other organizations for resources. Organizations compete for funds from financial institutions and good candidates from universities. Sometimes managers have to choose specific competitors to face. A small computer company is certainly not willing to compete directly with IBM, a giant computer company. The small computer company is better off following IBM and competing with other small computer companies. Sometimes managers have to cooperate with competitors. Strategic alliances invite competitors to work together, perhaps to take on other competitors, or perhaps to expand their market potential.

Therefore, managers are required to be good at determining their specific competitors and how to deal with them.

d. Government

The government plays an essential role in the life of the organization. The government usually acts as a "referee" and ensures that the rules of the game are followed properly. With this role, the government will issue laws and regulations that will affect the life of the organization. The government also has an important role in the economic life of a society, although this role has always been controversial. In economics, classical economic theory says that the government does not need to intervene in society's economic. In the long run, nature will find its way to equilibrium without outside interference. On the other hand, the economic theory proposed by John Maynard Keynes, a British economist, says that the government should step in and play an active role in correcting conditions that are not in equilibrium. In the short term, there may still be imbalances that require government intervention. It seems that so far the economic role of government in most countries has been quite large. Communist/socialist countries even advocate a greater role for the government/state.

Through state-owned enterprises, the government becomes a direct competitor to an organization that happens to be in the same line of business. Garuda (a state-owned company) competes with Lion/Pelita (a private company). Although state companies are usually still limited to strategic areas. But the definition of strategic is not clear enough, such that in one society, the definition of strategic involves more sectors, while in another society, the sectors are more limited.

Managers also need to understand government decision-making processes. Although the government is expected to be a fair arbiter, decision-making will be characterized by conflicts of interest. Interested parties will "lobby" the government to issue regulations that are somewhat advantageous to themselves, while other parties with opposing interests will also do the same. If the interested parties have equally strong positions, the outgoing regulation is likely to be a compromise of existing interests. Managers need to understand governmental decision-making in order to make appropriate anticipations.

e. *Financial Institutions*

The organization will depend on financial institutions or financial markets. Financial institutions provide the necessary financial capital inputs, either for setting up the business or for running the business.

Financial institutions are also intermediaries for organizations and the financial markets. The financial market will facilitate the flow of funds from those with surplus funds (savers) to those in need of funds or deficits (usually corporate organizations). Managers must pay attention to the dynamics of financial markets. Currently, many financial instruments are emerging to streamline the flow of funds from the surplus party to the fund deficit party. Organizations are able to choose funding in the form of debt, either from banks or by issuing debt securities (debentures) that are sold directly to investors. Another alternative is a form of ownership in which financial institutions participate or sell ownership securities (shares) to investors. The sale is usually done in the capital market. If funds are needed for short-term needs, organizations can obtain funds from financial institutions or sell short-term debt securities directly to investors. An example of short-term debt securities is Commercial Paper (CP). Organizations can also sell their assets, such as selling receivables (factoring) or mortgaging their assets. Managers can also rent assets (leasing) without the need to buy the assets directly. Managers must determine the cheapest and most flexible alternative of funding. Generally, there is a trade-off between the two. For example, the use of debt has a low cost of capital but reduces the flexibility of the organization.

f. *Other Groups*

In addition to the groups mentioned above, organizations also face other groups that are not yet mentioned in their environment. These groups usually depend on the organizational type of activities. Hospital organizations will deal with the organizations of doctors or nurses. A corporate organization will deal with trade union organizations. A manufacturing organization will deal with retailer organizations. Over time, there has been a tendency for the position of retailers to become stronger as they have access to the market. These groups will determine the fate of the organization.

B. ELEMENTS OF THE GENERAL ENVIRONMENT (INDIRECT ENVIRONMENT)

The general environment has no direct influence, at least at present, on the organization. The general environment affects the organization in two ways: (1) it encourages the formation of stakeholders, (2) it creates an environment in which the organization must anticipate changes. For example, higher education levels are making people more critical. Consumers are becoming more critical with more demands. Organizations must anticipate this kind of situation. An increasingly critical society can encourage the emergence of social organizations (NGOs) that fight for certain interests, for example the interest in a clean environment. The rapid development of computer technology also affects organizations. The way organizations work, from manual recording transactions, has changed to database development. Organizations must anticipate these changes. The development of technology also creates new stakeholders, such as new computer companies. For old computer companies, the presence of new computer companies increases competition. Here are some elements of the general environment: (1) social which consists of demographics, lifestyles, and social values, (2) economic, (3) political, and (4) technology.

1. Social

a. Demographics

Demographics involve the population structure of the environment in which the organization is located. Demographic changes will cause both opportunities and threats to the organization, depending on how the organization anticipates them. For example, the successful family planning program in the 1980s reduced the population of primary school age. As a result, many elementary schools are currently experiencing a shortage of students. In contrast, the population of children in the 1970s will become teenagers in the 1980s and adults in the 1990s. The arrival of this wave of people born in the 1960s will create certain opportunities. Adults need mature consumption products, such as housing (especially for those with families) and housing equipment. Population mobility also creates certain shifts. People usually move from villages to cities, with the aim of finding work opportunities. This wave of urbanization creates certain business opportunities as well.

b. Lifestyle

Lifestyle is the external manifestation of a person's attitudes and values. The lifestyle of society will change over time. For example, with more and more household couples working simultaneously (both husbands and wives are working), there are opportunities for daycare or childcare, as well as ready-to-eat meals that just need to be reheated. Another example is the lifestyle of today's young professionals, characterized by hard work, and leisure by going to the pub and dining out. Education has now started to become a career path for people and people value them even more than ever.

c. Social Values

Social values will influence an organization. For example, American society values individual effort and competition. Many managers are successful as they have high individual competitiveness. Bill Gates, founder of the computer company Microsoft, is an example of a manager who has high competitiveness even without great social skills.

Bill Gates was successful in the United States, but he probably wouldn't be as successful if he lived in, for example, Indonesia. Indonesian business society still relies heavily on business networking, which requires high social skills, and is overall less competitive. Japanese society emphasizes cooperation. Their organizations are characterized by a philosophy of cooperation, e.g. joint decision-making. French society, on the other hand, tends to be more formal, thus their organizations have structures that tend to be more rigid than organizational structures in the United States.

2. Economic Variables

Economic variables evidently affect the activities of an organization. If an economy is struck by a recession, it will be more difficult for an organization to move forward. Managers may look at the economic indicators to infer the existing economic conditions. These indicators include: inflation rate, unemployment rate, money supply, currencies exchange rate, composite stock price index, interest rate, Draft State Budget, and foreign exchange.

Economic changes can be structural, however, they can also be seasonal or cyclical. In statistical language, terms like trend, seasonal, cyclical, and random are widely familiar. Trend changes usually indicate structural changes, while seasonal changes are short-term, and last less than a year, and cyclical changes have a longer period, yet show temporary changes. Changes in the structure of the economy from an agricultural base to industry and even services are examples of structural changes. Whereas interest rate increases, inflation, or recessions are usually seasonal or cyclical. Managers must anticipate both types of changes differently.

3. Political Variables

Political variables will also affect the organization. Many rules and regulations that influence organizations are produced through the political process. The role of government in influencing organizational activities can be seen in the discussion of government as the direct external environment earlier. International politics will also affect the activities of an organization. For example, if the Democratic party in the United States is in control of the government, organizations in Indonesia will be more disadvantaged than if the Republican party is in control. Why? Because the Democratic party is more protectionist, they might try to protect the domestic industry of the United States, and to reduce imported goods because they are direct competitors to the domestic industry. Therefore, managers should pay attention to political changes in the country of the main trading partner.

4. Technological Variables

Technology has changed the way we live, though without much of a fanfare. Changes caused by technology are quieter than those caused by political revolutions. Technological changes will change the way organizations work, and also give rise to new stakeholders. More than that, the growth of technology is accelerating. Twenty years ago the PC computer was just launched. Now PC computers have greater capacity than the big computers of the 1950s. The changes that occur are also very fast. Ten years ago, Microsoft was still a relatively small company. Today, it is the largest software company in the world. Thus, predicting technological change is a very tricky job.

Technology is the application of basic sciences such as physics or basic chemistry. Observing the development of basic sciences will give clues to the shape of future technology.

5. International Dimension

The international dimension has become increasingly important in the era of globalization. The economies of the world's countries are becoming increasingly open. Multinational companies clearly have to pay attention to the international dimension. Companies with global logic will look for resources around the world with the aim of optimizing the use of these resources. Companies seek out capital in Europe as it is cheaper, set up factories in Indonesia due to its cheap labor, sell their products in the United States due to its large market, and have their headquarters in Japan. Local companies will also be affected by the international dimension. Competition with imported products will obviously affect local producers. If the rupiah strengthens against the dollar, the price of Indonesian goods will become relatively expensive, and it will become more difficult to sell those goods in the United States. Thus, the organization will be directly or indirectly affected by the international dimension.

Examples of Direct and Indirect Environment

Direct Environment are variables that directly affect the organization. The examples of Direct Environment are: 1. Employees, 2. Shareholders, and 3. Competitors. For example, if there is a change in the behavior of competitors, the organization will be directly affected. Another example, if a competitor becomes aggressive, the company will lose its market share (as the sales go down).

Technological change is not a direct environment. Technological changes affect the company indirectly. For example, technology is developing rapidly that the production of goods can be automated. These technological changes will change the behavior of competitors. For example, competitors might implement automation quickly, while the company does not. The company may experience a decrease in competitiveness as competitors are able to produce more goods faster and cheaper.

C. ORGANIZATION-ENVIRONMENT RELATIONSHIP MODEL

After discussing the dimensions of the environment, the following section will discuss the relationship model between the environment and the organization, as well as the strategies to deal with the environment.

1. Environmental Influence on Organization

James D. Thomson (1967) proposed a model of how the environment affects the organization. Two dimensions are introduced in the model, namely: (1) the degree of change, and (2) the degree of homogeneity. The rate of change implies an environment's degree of stability. A rapidly changing environment implies a high rate of change. The degree of homogeneity implies the degree of complexity of an environment. A complex environment, which has many elements, is said to have a low level of homogeneity. The two dimensions form the degree of environmental uncertainty as shown in the following figure.

Table 2.1
Model of Environment-Organization Relationship

Level of homogeneity/ Rate of Change	Stable	Dynamic
Moderate	Low Uncertainty	Moderate Uncertainty (1)
Complex	Moderate Uncertainry (2)	High Uncertainty

If the environment is rapidly changing and has complex elements, the environment is said to have high uncertainty. Another extreme point indicates an environment with a low rate of change and has clear environmental elements.

Food companies have an environment with low uncertainty. Changes in the industry are relatively slow. People need food, and the change in population is not rapid. The elements in the industry are also relatively simple. Food companies usually operate in a mature industry with a low level of technology.

A clothing company may be operating in an environment of moderate uncertainty (1) that is a combination of dynamic change with simple environmental elements. Clothing companies are characterized by changes in fashion and rapidly changing tastes. But the environmental elements of the company are relatively simple. Automobile companies can be classified into companies operating in moderate uncertainty environments and, (2) the automobile environment does not show rapid changes. However, since automobile companies are usually large companies with large networks (thousands of suppliers, thousands of employees, and government-based vehicle safety regulations), the environmental elements of automobile companies are quite complex.

Computer companies are classified as companies in high uncertainty environments. The environment of these companies changes very quickly. Both software and hardware update regularly in a matter of months. The environmental elements of a computer company are also very complex. Suppliers, competitors, as well as relationships with other sectors (e.g. audio-visual; computers now have sound capabilities similar to conventional audio equipment and visuals similar to conventional TV) form complex environmental elements. Managers' anticipation for each environment will be different.

2. Five Forces of Competition

Another way of looking at the environment is by using the five forces of competition framework developed by Michael Porter. According to Porter (1985), in seeking profit, companies will compete with five forces. The five forces are:

a. threat of new entry or barriers of entry;
b. substitute products;
c. bargaining power of suppliers;
d. bargaining power of buyers;
e. rivalry among existing competitors.

If a company operates in an environment where all five forces are strong, the environment may not be very attractive in a sense that the environment does not offer high profit possibilities. If the five competitive forces are weak however, then it is an attractive environment, as the organization is able to gain a greater share of the profits than the five forces.

Let's take a food restaurant as an example. The restaurant will face the threat of new restaurants or food stalls. Practically, setting up a restaurant is quite easy as it does not require high technology and capital. Thus, the threat of new entrants is quite strong. The opposite example is companies specializing in utilities such as electricity. Setting up an electric utility company is not an easy task as it requires a huge amount of capital. Thus, the threat of new entrants for electricity companies is relatively small.

The threat of substitute products for restaurants is relatively high. There are quite a lot of foods competing for a place in Indonesia. However, the habit of most Indonesians is to cook their own food.

Suppliers, on the other hand, seem to have a fair amount of power. Restaurants in Indonesia can easily obtain raw materials for their business. If suppliers, such as chicken suppliers, tend to be more concentrated that it forms a monopoly or oligopoly, the supplier's power becomes greater and thus threatens the restaurant.

Buyers seem to have considerable power as they have plenty of choices. Restaurants or food stalls can be found everywhere easily. Buyer loyalty also seems to be quite low since buyers prefer to eat a variety of foods, from Padang cuisine, and Javanese food, to even McDonald's hamburgers.

The intensity of restaurant competition is quite high since food stalls can easily be found everywhere. In addition, there isn't any restaurant association that usually tends to cooperate rather than compete. Price competition is also common. Many restaurants offer low prices and therefore resulting in less profit. As long as they can eat as well, the restaurants seem to be quite satisfied.

In general, by evaluating these five competitive forces, the industry of restaurants is not quite attractive to sought after. After evaluating the attractiveness of the industry, the next step is to determine the right strategy for the industry, which will be further discussed in the strategic management section.

Entry Barriers Example

Pharmaceutical companies, by nature, develop barriers to new entries. It costs a lot of money to produce one medicine. These costs include research costs, test costs, registration costs at the Ministry of Health, and other costs. New medicines will not get immediately successful once they reach the market. Among dozens of new medicines, only one might be successfully marketed (to pass the drug test and be accepted by the market). However, once successful, the medicine can generate huge profits. Therefore, only companies with very large funds can enter the pharmaceutical sector. The enormous cost of producing medicine is a barrier to entering the pharmaceutical sector. Government regulations are another example of barriers to entering the pharmaceutical sector. For instance, suppose the government decrees that only Company X can supply flour. Other companies are effectively prevented from entering the country's flour market.

Existing competitors are not deemed as barriers to entry since they have already entered the market. The threat of substitute products is also not an entry barrier. For example, herbal medicine is a substitute for medicine, but herbal medicine does not prevent other companies from entering the pharmaceutical sector.

3. Strategy in Dealing with the Environment

a. Influencing the Direct Environment

Managers can try to influence the direct environment in several ways: lobbying, advertising, bargaining, or negotiating. Managers can "lobby" the government to issue regulations that are in line with organizational goals. Managers can advertise new products and try to persuade consumers to try the new product. To a certain extent, managers might try to change people's behavior. For example, the soft drink industry such as Coca-Cola, and Pepsi, advertises soft drinks for breakfast. Usually, breakfast is accompanied by a hot drink such as coffee or tea. But they are trying to change people's habits to drink Pepsi or Coca-Cola for their breakfast. Managers can form strategic alliances with parties in their environment. A merger is one example of a strategic alliance. Managers can also make strategic decisions, for example, by seeing the increasingly high cost of labor in developed countries, managers can make decisions to set up factories in developing countries where labor costs are still cheap. In dealing with Trade Unions, managers can try to negotiate. Negotiation techniques are used in this kind of situation.

b. Monitoring Indirect Environment

With active monitoring, managers are expected to get an early warning if there are changes in the indirect environment that will have a significant impact on the organization. The manager, in this case, will take an active approach. To monitor, managers must create an environmental information system. Information can come from consumers directly through salesmen, through popular publications such as magazines and newspapers, and scientific publications such as academic journals. Relevant data can be collected and analyzed, then future period forecasts can be made. In such way, managers can anticipate changes in the economic, political, and social environment well.

c. *Adjusting to the Environment*

In certain situations, making adjustments to the environment is the best alternative. If environmental forces cannot be changed, managers are forced to adjust to the environment. The adjustment process can be done formally in management or through strategic planning. In such planning, managers will set goals, evaluate the environment, then determine an appropriate strategy.

Other adjustments can be made by changing the organization, its structure, or its design. The organizational design is structured in such a way that it can fit the organization's environment. For example, an organization with a stable environment will be more suitable to use an organizational design that maximizes efficiency. Standardized work processes and formal working relationships may be appropriate. In contrast, if the organization is in a dynamic environment, a flexible organizational design is required. With such a design, the organization is expected to be able to respond quickly to changes in the environment.

Exercise

To understanding of the material above, please complete the following exercise!

1) Observe how technological developments can change the business environment. Take an example of a new company that has grown in accordance with technological developments. Take Gojek and Grab (online transportation) as examples, and compare them with conventional ojek and taxis. Explain how technological change affects the two business models, namely online transportation and conventional transportation.
2) The pharmaceutical sector is usually highly profitable (an attractive sector). Using the five forces of competition model, analyze the reasons why this is the case.

Key Ideas for Exercise Answer

1) Observe the companies in the two business models (online and conventional). Assess the technologies the two business models use. Evaluate the value or advantages that are offered by the technological developments, and how they become the highlight of the online business model. For example, for an online ojek, the customer just needs to order through the application, then the ojek will come to pick them up. For conventional ojek, the customer has to go to the ojek base. Online ojek is therefore more convenient and practical.

2) Use the five forces of competition model. Analyze the pharmaceutical sector in terms of: competitors, barriers to entry, threat of substitute products, suppliers, and buyers. Evaluate whether each of these sides has high or low bargaining power over pharmaceutical companies. Low power will make the sector attractive.

Summary

This learning activity discusses the organizational environment. The organizational environment can be divided into external and internal environments, as well as direct and indirect environments. The external environment is an element outside the organization that is relevant to the organization. While the internal environment is a component within the organization that is relevant to the organization. The direct environment affects the fate/survival of the organization directly and includes both external and internal environments. Some examples of the external direct environment are consumers, suppliers, competitors, governments, financial institutions, and other groups. While examples of internal direct environments are employees, boards of commissioners, shareholders, and stakeholders.

Indirect environmental elements are environmental elements that do not directly affect the organization. Some examples of indirect environments are socio-demographic variables, lifestyles, social values, economic variables, political variables, technological variables, and international environmental variables.

There are several models of the organization's relationship with the environment such as the social change matrix, the degree of homogeneity of the social environment, as well as Porter's five forces model. Organizations can use strategies that affect the direct environment, monitor the indirect environment, and adjust to the environment.

TERMS INDEX

Direct Environment	Stakeholders Network
Indirect Environment	Demography
Internal Environment	Lifestyle
External Environment	Social Value
Board of Commissioners	Organization-Environment Relationship Model
Shareholders	Porter’s Fiver Forces
Stakeholders	Strategy in Dealing with the Environment

Formative Test 1

Choose the correct answer!

1) The party that decides the fate of an organization is called ....
   A. stockholder
   B. stakeholder
   C. bondholder
   D. general environment

2) The environment that is related to the population structure is called ....
   A. sociology
   B. topography
   C. demography
   D. anthropology

3) Coca-Cola and Pepsi are trying to change people's behavior to drink softdrinks for their breakfast (instead of tea or coffee). This action is an example of ....
   A. monitoring the environment
   B. adjusting to the environment
   C. changing the environment
   D. cooperate with the environment

4) Using Porter's theory, a very large investment made by a pharmaceutical company is an example of ....
   A. barrier to entry
   B. substitution
   C. competition
   D. bargaining power of buyers

5) One of the techniques to bring the interests of shareholders closer to employees is ....
   A. fixed salary system
   B. five forces of competition
   C. union
   D. employee stock ownership plan (ESOP)

Use key answers for Formative Test 1 which is located at the end of this module to determine the correctness of your answer. To make sure your mastery of the learning materials use the following formula.

$$\text{Level of mastery} = \frac{\text{Number of correct answers}}{\text{Number of test item}} \times 100$$

Level of master is as follows

<70%	70% - 79%	80% - 89%	90% - 100%
lower than expected	adequate	good	very good

When you attain level of mastery 80% or more, very good, you may continue to Learning Activity 2. Otherwise you have to review the material of Learning Activity 1. Pay attention to parts which you don’t master yet.

Learning Activity 2

Business Ethics and Social Responsibility

The larger the business organization, the greater the demands that society places on it. Large business organizations are actually a new phenomenon which only began to emerge in the early 21st century. Previously, business organizations were considered small organizations. In the beginning, some of these large business institutions had unfavorable behaviors, such as using unhealthy means to destroy opponents and preventing fair competition. Such behavior received negative reactions from society, which in turn forced the government to implement regulations to govern such business behavior. For example, Rockefeller in the United States engaged in practices that prevented fair competition. The US government then issued many regulations to prevent unfair competition, such as the antitrust law. This learning activity will discuss business ethics. Managers are expected to be sensitive to this issue, both morally as well as under the pressure from society.

A. ETHICS IN ORGANIZATIONS

Ethics can be defined in many different ways. For example, ethics can be defined as a person's beliefs regarding good or bad behavior. Other definitions are broader, as ethics relates to an organization's relationship with outsiders as well as insiders. Ethics in this case is defined as the study of how a decision affects others. Combining the two definitions, ethics is defined as the study of a person's rights and obligations, of the moral rules that people use in making decisions, and of the characteristics of human relationships. Moral in this case has the meaning of good or bad. An action is said to be ethical if it conforms to the accepted norms of society, and unethical if it does not conform to the social norms prevailing in society.

In an organization, ethical questions fall into one or more levels of ethics. These levels are individuals, internal policies, stakeholders, and society. Stakeholders refer to the parties that determine the fate of the organization.

The examples of stakeholders are suppliers, competitors, and workforce. The four are interrelated, thus they cannot be completely separated from one another.

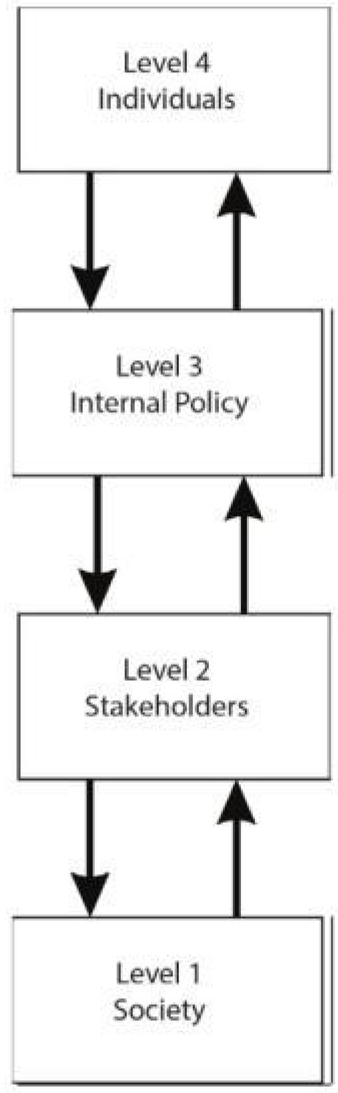

Figure 2.2
Levels of Ethics

The first level involves a question addressed to society, is a society ethical enough? For example, was the South African state (at the time of apartheid), when the basic rights of the black community were denied, ethical enough? Is capitalism a fair system of resource allocation? The next level involves stakeholders. At this level, the question is how will an organization deal with external parties who are affected by the organization's decisions, in addition to how should stakeholders deal with the organization itself. For example, how should a company sell its products to consumers, should it be accompanied by complete information, including information about its negative and positive effects? Should cigarette companies inform consumers about the dangers of smoking? Should a product (e.g. soap) be free of haram elements (e.g. pork)? Should an organization report its financial condition frankly to its investors? At the corporate discretion level, the questions asked to relate closely to the organization's relationship with its managers and employees. Some questions are, are employee salaries fair enough? Is a minimum salary necessary for employees? Are the salaries of managers and directors too high compared to the salaries of employees, after considering the contribution of each party? What are ethical work rules, leadership, and motivational methods?

Finally, we come to the individual level. At this level, the relationship between individuals in an organization is questioned. The relevant questions at this level are, what are the obligations of subordinates to their superiors, and the obligations of superiors to their subordinates? Do employees have to be straightforward (honest) with all the consequences to fellow employees? Do employees have to be loyal to the organization?

Ethical questions must be asked through all four levels. Because behavior reflects the basic rules that apply in society. Ethical questions are critical questions about the basic rules that apply in a society, which may already be well-established or may still require efforts to improve the basic rules.

B. ETHICAL VALUE FORMATION

An individual's ethics are influenced or shaped by several things: family, situational factors, values, morals, religion, experience, and peer influence. Figure 2.3 below shows said influences.

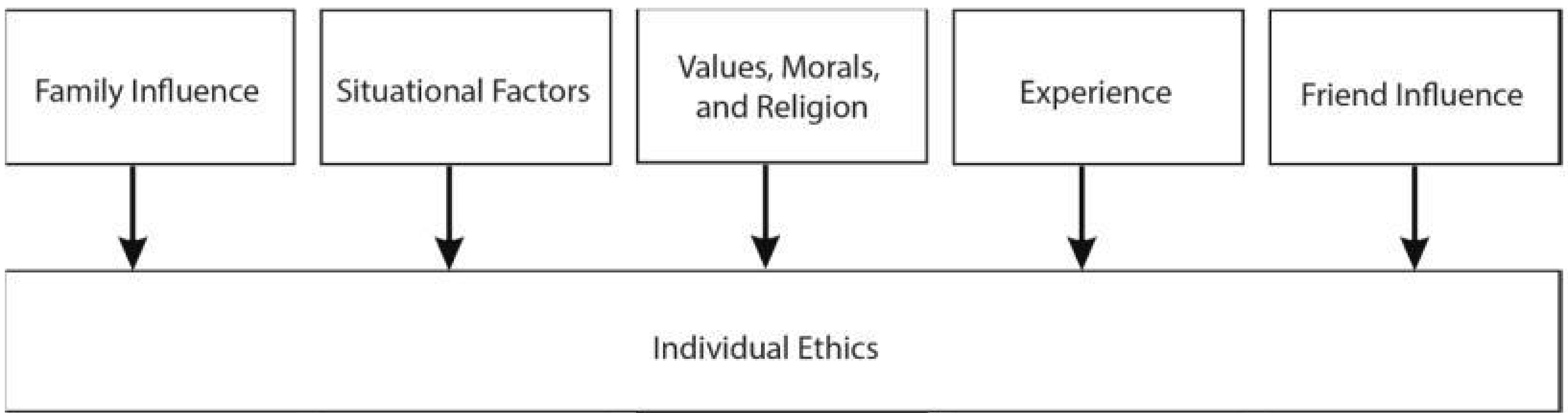

Figure 2.3
Factors Affecting Individual Ethics

1. Family Influence

The family is where an individual grows up, therefore the family has an important influence in the formation of an individual's ethics. Individuals will behave to imitate the behavior of their parents or close family, or behave as their parents tell them to. Families that behave ethically will encourage individuals to take ethical actions, even into their adulthood.

2. Situational Factors Influence

Situations will determine an individual's ethics. For example, a person who steals may have the excuse that he needs the money to pay for his sick child. Although it may seem like a shortcut, such situation helps to explain why a person may commit an unethical act.

3. Values, morals and religion

A person who prioritizes personal success in achieving financial goals will certainly have different behaviors than those who prioritize helping others. Managers' decisions and behaviors are often influenced by their beliefs. For example, a manager who believes in the value of unity will not lay off his employees even if the company is experiencing difficulties. Religion or interpretations of religion also often influence managers' decisions and behaviors. For example, some social scientists argue that capitalism in developed countries such as the United States, Germany, is due to Protestant teachings that encourage success in the world as evidence of people who will be accepted by God in the afterlife. People who do not succeed in the world will not be accepted by God. Therefore, they will strive to work hard in this world. Some scholars also argue that Japan's progress is inseparable from the Confucianism beliefs.

4. Life Experience

During their life, humans experience both good and bad experiences. These experiences are a normal process in one's life. These experiences will shape the ethics of a person. For example, someone who steals and is never caught may be encouraged to steal again in the future. On the contrary, if he is caught and punished, it may deter him from committing theft in the future.

5. Peer Influence

Peers will particularly influence the formation of one's ethics. The best example of this is the period of childhood. If a child is friends with a naughty child, there is a tendency for the child to become naughty as well. The same applies to playmates during an individual's adolescence. If the environment has a higher standard of ethics, an individual will tend to have higher ethics as well.

C. ETHICS IN ORGANIZATIONS

Ethics in organizations arise from the relationship between the organization and external as well as internal parties. Three kinds of ethical areas in organizations can be seen in the following table.

Table 2.2
Areas of Ethics in Organizations

Areas of Concern	Example of Relevant Issues
Organizational relations with employees	» Employment attraction, payroll, and termination of employment » Working conditions » Individual freedom
Employee relations with the organization	» Conflict of interest » Organizational confidentiality » Honesty
Organizational relation with external parties	» Customers/consumers » Competitors » Shareholders » Suppliers » Government » Surrounding community

An organization's relationship with its employees results in certain standards of behavior that are considered ethical and unethical. For example, it is unethical to pay employees less than the minimum wage. It also needs to be further questioned whether the payroll is fair or not. Usually, employee pay is based on market rates, that is, the prevailing wage in the market, not on the employee's contribution to the company. Some techniques such as profit sharing seem ethically preferable because they recognize the employee's contribution to the organization's goals. While the issue of employee wages usually revolves around the minimum wage, salaries for directors are controversial as they are exceptionally high. In the United States, a Vice President of Walt Disney earned nearly US$100 million in salary and income after only one year of service. Shareholders are certainly not happy because he has not contributed anything to the organization for a year.

The employee's relationship with the organization includes issues such as conflicts of interest, honesty, and maintaining organizational confidentiality. For example, when an employee moves to a competing company, he or she will face the choice of whether or not to tell the secrets of the previous company. When the Director of Operations moved to a European car company, General Motors alleged that he had leaked GM's strategic information. Employees are also expected to behave honestly and be loyal to the organization. The director or head of the purchasing department of a particular agency or organization often faces ethical issues. Whether to buy components or supplies from suppliers with the best price and quality, in compliance with the interests of the organization or to compromise with suppliers who provide him with rewards, which will turn his decisions against the interests of the organization. Some organizations have clear rules on such matters, such as strictly prohibiting gifts from suppliers. In the United States, police are prohibited from accepting gifts, especially during duty hours.

Organizations are also required to behave ethically toward the external environment. The external environment of the organization can consist of stakeholders, the environment, and the prosperity of society in general. The following are several examples of stakeholders, which are the parties that can determine the survival of the organization.

Table 2.3
Example of Stakeholders

Stakeholders	
Central government Consumers Local government Local community/society Creditors/banks Suppliers Foreign Government Employees	Justice system Interest groups Capital market authorities Shareholders Trade associations Universities Suppliers Foreign governments

For stakeholders, for instance, organizations must deliver financial statements that are not misleading to their shareholders. Capital market authorities such as Capital Market and Financial Institutions Supervisory Agency are interested in clean trading practices. Therefore, cases of fraudulence such as fraud (for example, the use of funds from the sale of shares isn't in accordance with what was promised by the prospectus) or insider trading (making transactions using information that has not yet become public) will always be avoided. Another growing issue is the issue of environmental damage as a result of economic growth. In general, this kind of damage will remain unaccounted for by in-business analysis and will be the responsibility of outsiders. Society in this case will bear the consequences. For example, a company builds a factory and dumps its waste in a river. The company will earn profits, and the local people who work there will earn their income as well, however, the river will suffer from pollution. The polluted river causes various diseases, people's income will be indirectly decreased, as the earned salary ends up reduced by the costs incurred to treat the disease. Including the cost of environmental damage into the organization's account is often referred to as internalizing economic analysis.

It is the same with businesses that exploit natural resources such as forests or other mines. If a business simply depletes the forest, without any attempt to renew it, then the business is simply depleting the existing resources. Just like a family depleting their parents' inheritance, without any effort to develop the inheritance itself. Development that takes efforts in renewing the resources into account is often referred to as sustainable development. Businesses also have to promote the prosperity of society in general. Some businesses carry out this duty by making donations to non-profit organizations, such as donations to museums, symphonies, and efforts to improve public health.

Examples of Ethical Actions

1. The company pays employee salaries in compliance with the agreed agreement.
2. The company helps the development of the surrounding community.
3. The company does not bribe government officials.
4. The company does not hire underage employees.
5. The fund manager does not trade stocks using private information (information that hasn't been made public yet).

Ethical actions can be easily distinguished from unethical actions. Here are some examples of unethical actions.

1. A mining company does not want to repair the environmental damage caused by its mining business.
2. A manager bribes a government official to win a contract.
3. The company falsified the expiration date to allow old products to be sold again.
4. The fund manager trades using private information to make large profits.

D. ARGUMENTS FOR AND AGAINST SOCIAL RESPONSIBILITY

Social responsibility is the implementation of ethical demands by an organization, in relation to the demands of the environment or parties related to the organization. Although it seems that the argument for corporate social responsibility is quite strong, there are still controversies in favor and against corporate social responsibility.

The following table summarizes the arguments for and against corporate social responsibility.

Table 2.4
Pros and Cons of Corporate Social Responsibility

Social Responsibility Pro Arguments	
1.	Businesses are members of society, and therefore have an interest in the progress and well-being of the society in which they operate.
2.	Social action can increase profits.
3.	It is ethical.
4.	Increase the good impression (image) of the business in the eyes of the public.
5.	Businesses exist because they contribute to society. The community can withdraw the assignment if the business cannot contribute its best.
6.	It is necessary in order to avoid government regulations.
7.	Social norms require businesses to undertake social responsibility.
8.	Laws cannot be made for every situation, so businesses must maintain the peace of law by filling the gap.
9.	Consistent with shareholder interests. Social responsibility will increase the share price as the business becomes less risky, i.e. less likely to be attacked by the public.
10.	Society should allow businesses to solve problems that the government cannot.
11.	Businesses have the human and financial resources to solve social problems.
12.	Preventing problems is better than treating them, let businesses solve their problems before they get bigger.
13.	Businesses create problems, therefore they must solve them.
14.	Businesses are partners in society, together with the government and society

Social Responsibility Pro Arguments	
1.	Social action cannot be measured.
2.	The goal of a business is to maximize profits.
3.	Involvement in social work gives businesses more power.
4.	Businesses do not have the expertise to run social programs.
5.	There is a potential conflict of interest.
6.	The cost of social responsibility is too high, which will push prices too high.
7.	Social responsibility will put pressure on the balance of payments as the product becomes uncompetitive in the international market.

The pro argument basically assumes that companies are part of society. Furthermore, companies or businesses have considerable power. They can determine the amount of employment attracted and can increase the income of the community. Because of this power, companies have an obligation to maintain or increase the prosperity of society. Power must be accompanied by obligation. Social programs undertaken by the company will increase the profitability of the company, at least in the long run. Thus, by undertaking social responsibility, companies can increase their profits.

The counter-argument argues that if companies are required to carry out social responsibility, there will be a conflict between economic goals and social goals. The company will not survive because it is forced to perform these contradictory tasks. One of the figures supporting the counter-argument is Milton Friedman, an economist from the United States. Friedman argues that social responsibility is even unethical, as managers are forced to spend money that should belong to shareholders.

The following Table 2.5 reports the results of a survey of 560 top executives of companies from several business sectors. They were asked to respond to the potential positive and negative effects of corporate social responsibility.

Table 2.5
Positive and Negative Effects of Corporate Social Responsibility

Positive Effect	Proportion of People Expecting
Enhance the organization's reputation	97,4%
Strengthens the social system in which the organization exists	89,0
Strengthens the economic system in which the organization is located	74,3
Higher employee job satisfaction	72,3
Avoiding government regulations	63,7
Higher executive job satisfaction	62,8
Higher probability of survival for the organization	60,7
Can attract better managerial talent	55,5
Increases long-term profitability	52,9
Strengthens the pluralistic characteristics of society	40,3
Retains or gains customers	38,2
Investors favor responsible companies	36,6
Increase short-term profitability	15,2
Lower short-tem profitability	59,7
Conflict between economic and social goals	53,9
Increase the price charged to consumers	41,4
Conflict on criteria used to evaluate management performance	27,2
Dissatisfaction from investors	24,1
Lower productivity	18,8
Lower long-term profitability	13,1

Positive Effect	Proportion of People Expecting
Increases government intervention	11,0
Weakens the economic system in which the organization is located	7,9
Weakens the social system in which the organization is located	3,7

It appears that on the positive side, around 97.4% of respondents expect the organization's reputation to improve. This is their highest expectation. As for negative effects, there are 59.7% who think that social responsibility causes a decrease in short-term profitability. In general, positive effects have a higher expectation level than negative effects.

E. APPROACH TO SOCIAL RESPONSIBILITY

Organizations have different patterns in carrying out social responsibility. The approaches can be viewed as continuous and are often used overlappingly, organizations would sometimes apply the contribution approach, and the social obligation approach at other times. Figure 4 below presents these approaches.

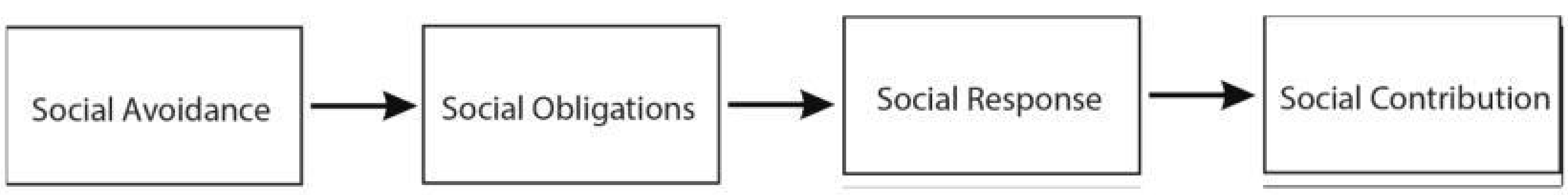

Figure 2.4
Approaches to Social Responsibility

Social Avoidance. Some organizations try to minimize their involvement in social issues. If faced with social problems, these organizations will try to deny or cover up the problem.

Social Obligation. Social obligation is a step further for the organization, where it seeks to meet its social obligations, especially those that are legally required such as meeting government regulations. This approach is consistent with the arguments against social responsibility. Since a company's organizational obligation is to make a profit, it is unwillingly forced to carry out its social obligations. For example, the company may install only the minimum amount of pollution prevention equipment, even though better equipment is available. Because it is not required, the company does not install the equipment. In developed countries, tobacco companies can only promote in certain media, and must print health warnings on their products. In other countries such as developing countries, which do not have strict regulations, warnings are often not posted, while promotion is much more vigorous.

Social Response. Organizations that use this approach strive to meet their minimum obligations and go beyond them all at the same time. The company is willing to participate in social programs, but they must be convinced that the programs are beneficial to the organization. The organization is willing to contribute to social programs, but uses a passive approach. Meanwhile, other parties must actively knock on the company's door if they want the company to participate in social programs.

Social Contribution. This approach is the highest stage in which the organization actively participates in social programs. This approach is the most consistent with the pro-social responsibility argument. The organization sees itself as part of society and actively seeks ways to contribute to society.

The Body Shop

The Body Shop is a cosmetics company that strives to combine business values with ethical values. The company was founded by Anita Roddikc in Brighton, England, in 1976. Anita Roddick believed in a revolutionary idea, that business could be a force of goodness. The Body Shop strives to be a company that encourages environmental conservation, for example: The Body Shop does not test on animals, uses natural materials, and always tries to use materials that can be recycled. Body Shop is often regarded as a model of a company that fulfills the image of being "socially responsible". However, Body Shop is not without controversy. There are several criticisms, such as the use of natural ingredients does not guarantee that they are safer for consumers. The claim of not using synthetic materials at all also seems unlikely. The idea of the Body Shop establishment has been accused of not purely generate from the founder, but taken from other established stores. The founder's claim that she traveled the world in search of exotic beauty ingredients was considered a fabrication. Body Shop was accused by Pellt of making donations. The question always arises: Can a business manage to develop social and organizational values at the same time? Are there examples of companies that can combine the two? (*https://www.thebodyshop.co.id/*)

F. SOCIAL RESPONSIBILITY MANAGEMENT

This section discusses how an organization can plan its social responsibility. An ideal approach would include: (1) incorporating social objectives into the annual planning process, (2) determining industry standards which is used to compare the achievement of social programs, (3) reporting the progress of social programs to the members of the organization, (4) improving trial and error on how to achieve social objectives, (5) attempting to calculate the costs and benefits of social programs. The approach discussed is an active approach that is compatible with the social contribution approach. Organizations employing this approach are expected to have a higher social sensitivity than those with social obligation approach.

The following figure illustrates the planning and implementation of social responsibility, from goal setting to implementation plans.

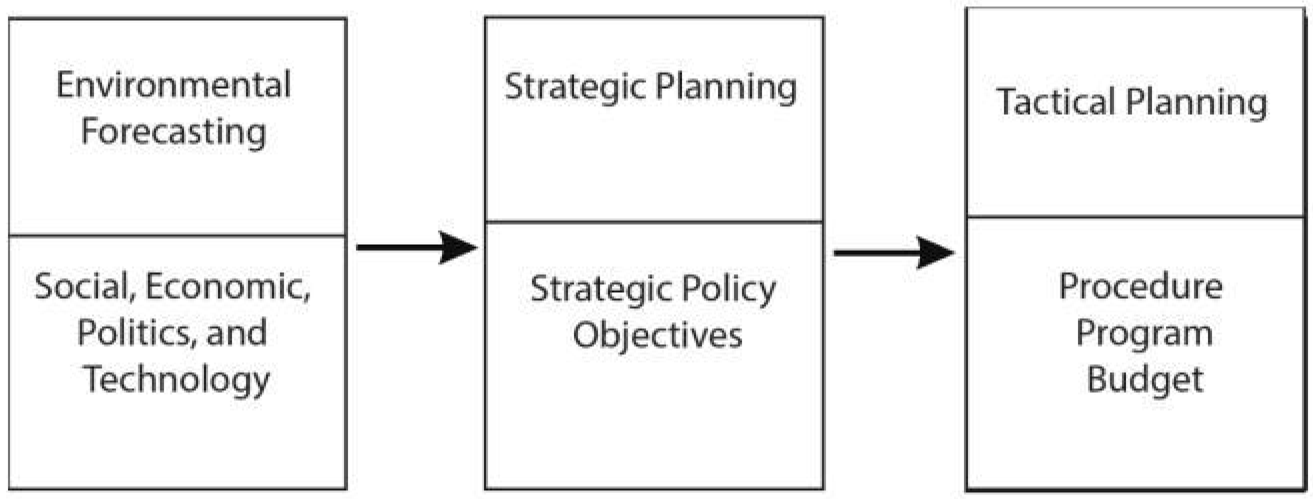

Figure 2.5
Stages in Social Responsibility Planning and Implementation

Planning for social responsibility includes two things: (1) determining how social responsibility activities planning process relates to the organizational planning process, and (2) translating social responsibility policies into the necessary measures. The first step in planning is to forecast future social issues. For example, management can expect environmental issues to become increasingly important, and expect bureaucratic hygiene to become important as well. This way the organization is actively approaching the problem. Afterwards, it coordinates with existing economic plans. For example, some social tasks may be carried out using resources intended to achieve economic goals.

Then, strategies and policies to achieve these goals are established. It is better if the policies cover not only specific objectives, but general objectives as well, for example a policy on fair labor attraction. The next step is to translate these strategies and policies into specific actions, which are then accompanied by budget allocations. Organizations can use existing human resources to implement social programs. For example, the Finance Director becomes the manager of social activities. Another alternative is to use resources dedicated to implement social programs. For example, the Deputy Director of Legal and Public Affairs is specialized to handle social issues. Thereafter, similar positions are established.

The next stage in social responsibility management is social control. Social control can be carried out on some specific areas, or carried out for more general purposes. There are four areas of social goal measurement where each area requires more specific measurement.

1. **The economic area**, measurement is made to see whether the organization performs basic economic tasks. For example, producing goods, paying reasonable wages, and creating good working conditions.
2. **Quality of life area**, measurement is done to see if the organization improves the quality of life in general. For example, whether the organization succeeds in creating quality goods, preserving the environment, and such.
3. **Social investment area**, measurement is done to see the extent of resource investment (money and people) made by the organization to help problems faced by the community such as education, recitation, and so on.

4. **Problem-solving area**, measurement in this area intends to see the extent to which the organization succeeds in solving social problems, rather than addressing the symptoms that arise. Participation in long-term community planning and studies to identify social problems are examples of problem solving (activities aimed at solving problems).

A broader measure of social purpose is referred to as a social audit. A social audit is a formal and thorough analysis of an organization's social performance. It can be conducted by a task force from within the organization, or by an outside party. They are not usually conducted frequently, as they are expensive and time-consuming. The following are examples and formats of social audits. The format and scope of the analysis may vary depending on the situation.

Table 2.6
Social Audit

Issue: Enhancing Small Business Partnerships
Potential Issues: Pressure from the community to help small entrepreneurs, as well as government regulations and encouragement on this issue. Government monitoring is very likely to happen. If an organization decides not to do so, it may gain a bad reputation and lose out on new business.
Progress made so far: Currently working on procedures used to evaluate applications for small business partnerships. Expected to be completed this year. Estimated cost is around Rp40 million. Outside consultants are being utilized in this regard.
Current problem: It is still difficult to distribute funds due to a lack of information on small entrepreneurs. So far, only Rp500 million has been disbursed out of the Rp5 billion target.
Position of the organization, relative to others: Other organizations are also experiencing the same difficulties, so the organization's reputation is not particularly bad (compared to others). If it manages to succeed faster than others, the organization has a chance to improve its reputation. New business opportunities can be obtained more easily.

Exercise

To understanding of the material above, please complete the following exercise!

Suppose you are the manager of a contracting company. The company has not received a contract for a long time, so the survival of the company and the fate of the employees have become uncertain. Then the government offers a construction contract. The government official offers the opportunity to win the contract, but the company must pay some money (read: bribe) to the official. Should the offer be accepted or rejected?

Key Ideas for Exercise Answer

Read this learning activity thoroughly. Using the arguments in this learning activity, explain whether it is ethical to accept the offer. If you do not accept the offer, the company may lose an opportunity that leaves the employee's fate uncertain. Discuss whether ethical behavior will lead to decreased competitiveness.

Summary

One of the components of an effective manager is ethics. Ethics involves the question of whether something is good or bad. In relation to organizations, business ethics questions whether or not a decision taken by the organization is good in relation to other related parties. There are four levels of ethical questions: individual, internal policy, stakeholders, and society. Each level has different types of questions.

Business ethics are influenced by several factors: family, situation, moral and religious values, experience, and friends. Understanding these factors enables managers to understand whether something is good or bad and to understand why people take certain actions (both ethical and unethical). Ethics in organizations can be grouped into several areas: the organization's relationship with employees, the employees' relationship with the organization, and the organization's relationship with outsiders. Some organizational decisions fall into one or more of these areas.

Social responsibility is the implementation of ethical demands by an organization to meet the demands of its environment. Although it seems that the Pro-Social Responsibility argument is quite strong, there is still controversy over the pros and cons of social responsibility. Organizations can use several approaches to corporate social responsibility, namely avoidance, obligation, response, and social contribution. Social contribution is the approach that best fits the Pro-Social Responsibility argument. Social responsibility management includes planning, implementing, and controlling social activities or programs. It would be better if social planning is integrated with existing planning, which is planning for economic activities.

TERMS INDEX

Business ethics
Stakeholders
Levels of ethics
Internal policy
Society level
Sustainable development

Milton Friedman
Social avoidance
Social obligation
Social responsibility
Social response
Social contribution

Technical innovation management
social audit

Formative Test 2

Choose the correct answer!

1) Development that considers efforts to renew the used resources is often referred to as ....
   A. sustainable development
   B. continuous development
   C. integrated development
   D. newable development

2) Here is an example of an ethics question ....
   A. Has the company met its profit target this year?
   B. Is Indonesia's economic growth high enough?
   C. Does the company need to bribe government officials to obtain contracts?
   D. Can a new product succeed in making a profit?

3) The highest stage in the implementation of social responsibility is ....
   A. social contribution
   B. social avoidance
   C. social obligation
   D. social response

4) The measurement of an organization's achievement of social goals is called ....
   A. ethics audit
   B. social responsibility audit
   C. ethical profit audit
   D. social financial audit

5) In relation to the corporate social responsibility controversy, Milton Friedman argues ....
   A. companies should prioritize ethics
   B. a company's job is to make profit
   C. companies should make profits in an ethical way
   D. companies should spend adequate social responsibility funds

Use key answers for Formative Test 2 which is located at the end of this module to determine the correctness of your answer. To make sure your mastery of the learning materials use the following formula.

$$\text{Level of mastery} \quad \frac{\text{Number of correct answers}}{\text{Number of test item}} \times 100$$

Level of master is as follows

<70%	70% - 79%	80% - 89%	90% - 100%
lower than expected	adequate	good	very good

When you attain level of mastery 80% or more, very good, you may continue to Learning Activity 3. Otherwise you have to review the material of Learning Activity 2. Pay attention to parts which you don't master yet.

Learning Activity 3

Globalization

This learning activity discusses globalization. Nowadays, nearly all aspects of life intersect directly or indirectly with globalization. For example, suppose there is an Indonesian company that exports its products abroad. If the Rupiah weakens against the US dollar then the company will be benefited, as its products will become less expensive when converted into dollars. What about companies that do not export their products abroad, nor do they import raw materials? Will globalization have an impact on such domestic companies? The answer is yes. For example, suppose the Rupiah strengthens against the dollar, then imported goods will become cheaper in Indonesia. The cheaper goods will obviously compete with the domestic company. The impact of globalization is also found in everyday life. Who doesn't know the products of multinational companies, such as McDonald's (food), Coca Cola (drinks), Pepsodent (toothpaste), and Lux (bath soap)? These names are highly familiar to us, and we may even use them every day.

Managers must have an understanding of globalization. This learning activity discusses the subject of globalization. The discussion starts with the definition of globalization, then continues with an overview of globalization, specifically the state of the world economy. It concludes with a discussion regarding multinational corporations, and strategies for penetrating global markets.

A. GLOBALIZATION

What is globalization? Globalization is something we hear a lot about. A more formal definition suggests that globalization has at least three dimensions: distance, location, and attitude.

1. Distance

Today, globalization is characterized by shorter distances between worlds. Physically, the distance between, for example, Jakarta and Singapore is still the same, which is about 800 km. But the travel time between Jakarta and Singapore is much different between ancient times and today. If in the past, Jakarta and Singapore were traveled in a day or more, then today, Jakarta-Singapore can be reached within an hour. Today's technology allows for shorter distances between countries in the world. This shortening of distances has many implications. Many corporate activities today involve units spread across the globe. International supply chains are common for multinational companies. For example, the car company Toyota can use raw materials from Indonesia, labor in China, and then sell their products in the United States. Distance is no longer an obstacle for companies to do such things.

2. Location

The shortening of travel distances, as well as the improvement of communication and transportation technology, has turned the scope of the company's operations global. Company operations are no longer limited by national boundaries, but extend beyond national borders. Even the identity of a company, whether a company is from a particular country, is increasingly blurred. For example, Nestle is a Swiss company, but its President Director is German. More than 98% of its revenue comes from outside Switzerland. More than 95% of its assets are outside Switzerland. The company has ten managers, but only five are Swiss. What retains its Swiss identity is that the headquarters is still in Switzerland, and Swiss investors still own about 50% of Nestle's shares. Some companies even have headquarters outside their home country. For example, Halliburton, an American oil company, which was founded and developed in the United States, decided to move its headquarters to Dubai in 2010. With the transfer, the company was no longer a legally recognized US company. With this new status, Halliburton could no longer bid for work offered by the US government for some strategic projects. For example, some US Department of Defense tenders can only be bid on by US companies.

3. Attitude

Globalization must be followed by an attitude that matches the demands of globalization. Otherwise, managers will be overwhelmed by the wave of globalization. This particular attitude is one that is open to globalization and one that is always ready to participate in the wave of globalization. Managers must always be open to learn new knowledge and to compete with other companies, even with companies from other countries. Interaction with foreign companies often boosts the company's competitiveness, if globalization is addressed appropriately. For example, South Korean and Japanese companies developed into global companies by studying global companies from the United States or other countries. Samsung, Honda, for example, developed as a global company by studying other global companies.

Globalization offers both opportunities and threats. If a company cannot provide the right response or attitude, it can be crushed by the wave of globalization. If the company can make the right response however, globalization offers many opportunities.

B. WORLD ECONOMY STRUCTURE

The following picture shows the map of the world. Readers may be familiar with the picture. There are five continents in the world, namely Asia, America, Europe, Africa and Australia. The continents are further divided into countries. Do you know how many countries are there in the world?

Figure 2.6
World Map

Currently there are about 150 countries in the world. How does the economy compare between these countries? Which country has the largest economic size in the world? Countries with large economies will certainly be attractive target markets for our products. The following table presents the 20 largest economies in the world, in terms of their Gross Domestic Product (GDP). GDP is the market value of products and services produced by a country in a given period. GDP is different from GNP (Gross National Product). GNP is the products and services produced by the population in a country during a certain period. For example, for Indonesia's GNP, Indonesia's GDP will be reduced by products and services in Indonesia that are owned by foreigners, then added to the GNP owned by foreigners, then add the products and services of Indonesians who are abroad.

The table below shows that in 2018, the world generated a total Gross Domestic Product (GDP) of approximately 79 trillion US dollars. The largest GDP-generating country was the United States, with a GDP of about 20 trillion US dollars. China is in third place with a GDP of about US$14 trillion. Europe as a whole ranks second with an economy worth about 19 trillion US dollars. Indonesia is in sixteenth place, with a GDP of about one trillion US dollars. Indonesia is currently part of the G-20 group, the world's 20 largest economies.

The next table shows the GDP for countries in ASEAN (the Association of Southeast Asian Nations). The largest GDP after Indonesia is held by Thailand, with a GDP of around 480 billion US dollars. Timor Leste occupies the lowest place in ASEAN, with a GDP value of around 2.7 billion US dollars.

The next table shows the ten countries with the lowest GDP in the world. The Vatican and Tuvalu occupy the first and second lowest places with GDP values of about 2 and 35 million US dollars. It can be seen that the countries with the lowest GDP are located in the African continent and Asia Pacific. Currently, Africa tends to have the highest poverty rate in the world. Asia Pacific countries tend to be small island nations.

Table 2.7
Countries with Largest GDP

Ranking	Countries	Milion US$
	The world	79,865,481
1	USA	20,412,870
	Europe	19,669,743
2	China	14,092,514
3	Japan	5,167,051
4	Germany	4,211,635
5	United Kingdom	2,936,286
6	France	2,925,096
7	India	2,848,231
8	Italy	2,181,970
9	Brazil	2,138,918
10	Canada	1,796,512
11	Russia	1,719,000
12	South Korea	1,693,246
13	Spain	1,506,439
14	Australia	1,500,256
15	Mexico	1,212,831
16	Indonesia	1,074,966
17	Dutch	945,327
18	Turkey	909,885
19	Saudi Arabia	748,003
20	Swiss	741,688

Source: IMF, 2019

Tabel 2.8
GDP Country ASEAN

Ranking	Countries/Region	GDP (Million US$)
16	Indonesia	1,074,966
26	Thailand	483,739
36	Malaysia	364,919
38	Singapore	332,449
0	Philipine	313,419
48	Brunei	14,438
126	France	2,925,096
164	Timor Leste	2,740

Source: IMF, 2018

Tabel 2.9
Countries with The Lowest GDP

Ranking	Countries/Region	GDP (Million US$)
172	Antigua dan Barbuda	1,612
173	Guinea-Bissau	1,582
174	Seychelles	1,569
175	Solomon Islands	1,377
176	Grenada	1,180
177	Gambia	1,085
178	Saint Kitts and Nevis	972
179	Vanuatu	957
180	Samoa	881
181	Saint Vincent dan Grenadine	835
182	Komoro	738
183	Dominika	476
184	São Tomé dan Príncipe	443
185	Tonga	433
186	Federasi Mikronesia	335
187	Palau	321
188	Kiribati	211
189	Marshall Islands	205
190	Tuvalu	43
191	Vatikan	2

Source: IMF

Another indicator of a country's prosperity is GDP per-capita. While GDP measures the total value produced in the country, GDP per capita is calculated by dividing the total GDP by the population of the country. Note that a large population in a country tends to lower its GDP per capita. Table 4 shows that the country with the largest GDP per capita in the world is Qatar, with a GDP per capita of approximately 130 thousand US dollars. The second place is occupied by Macau with a GDP per-capita value of $113 thousand US dollars. It can be seen that the countries with the largest GDP per capita are mostly from European and Arab countries. Singapore and Japan are Asian countries that are able to break into the top 20 countries with the largest GDP per-capita in the world.

The next table shows the GDP per-capita for countries in ASEAN. Singapore is the ASEAN country with the highest GDP per-capita, which is around $100 thousand. In the world ranking, Singapore is third in the world. Following Singapore, Brunei is second on the rank. Indonesia is 5th in ASEAN and 96th in the world with a GDP per-capita of around $13,000.

The next table presents the twenty countries with the lowest GDP per capita in the world. Just like before, the countries with the lowest GDP per-capita in the world are dominated by countries in Africa and Asia-Pacific. These results show that Africa and Asia-Pacific are the continents with the poorest countries in the world.

Table 2.10
Countries with the Largest GDP per Capita

Ranking	Countries	In US$
1	Qatar	130,475
	Macau	116,808
2	Luxembourg	106,705
3	Singapore	100,345
4	Brunei	79,530
5	Ireland	78.785
6	Norway	74.356
7	United Arab Emirates	69.382
8	Kuwait	67.000
9	Switzerland	64.649
-	Hong Kong	64.216
10	United States	62.606
11	San Marino	60.313
12	Netherlands	56.383

Ranking	Countries	In US$
13	Saudi Arabia	55.944
14	Iceland	55.917
-	Taiwan	53.023
15	Sweden	52.984
16	Germany	52.559
17	Australia	52.373
18	Austria	52.137
19	Denmark	52.121
20	Bahrain	50.057

Source: IMF, 2018

Table 2.11
ASEAN Countries' GDP per Capita

Rank	Country/Region	GDP (Million US$)
3	Singapore	100.345
4	Brunei	79.530
45	Malaysia	30.860
68	Thailand	19.476
96	Indonesia	13.230
112	Philippines	8.936
121	Vietnam	7.510
134	Timor-Leste	5.242

Source: IMF

Table 2.12
Countries with Lowest GDP per Capita

Rank	Country/Region	GDP (Million US$)
166	Rwanda	2,280
167	Solomon Islands	2,242
168	Kiribati	2,086
169	Afghanistan	2,017
170	Burkina Faso	1,996
	Guinea-Bissau	
171	Haiti	1,937
172	Togo	1,864
173	Eritrea	1,746
174	Comoros	1,657
	Madagascar	
175	Sierra Leone	1,632
176	South Sudan	1,630
177	Liberia	1,620
178	Mozambique	1,502
	Niger	
179	Malawi	1,418
180	Congo, Democratic Republic of the	1,291
181	Burundi	1,217
182	Central African Republic	1,199
183		767
184		732
185		712

Source: IMF, 2018

The world is experiencing dynamic developments. In the future, a shift in the world's economic power is expected to happen. In 2020, it is estimated that there will be a shift in the world's economic power in comparison to 2010. . Emerging economies will play an increasing role. China is expected to overtake the United States to become the world's largest economy. The increasing economic strength of several Asian countries is an opportunity for the business world, including consumption, electronics, and other equipment businesses. Of course, this economic development is accompanied with challenges to the environment. Rapid economic development tends to potentially damage the world's environment. The following table shows the estimated ten countries with the largest GDP in 2020.

Table 2.13
Ten Countries with the Largest GDP in 2020

Ranking	Country	GDP (in Million US$)
1	China	28.124.970
2	United States of America	22.644.910
3	India	10.225.943
4	Japan	6.196.979
5	Russia	4.326.987
6	Germany	3.981.033
7	Brazil	3.868.813
8	England	3.360.442
9	France	3.214.921
10	Mexico	2.838.722

The table shows that developed countries are experiencing an economic slowdown compared to developing countries. However, China and India are expected to grow rapidly. If in 2010, the percentage of China's economy to the world economy was around 13%, then by 2020, the percentage will be around 20%. In 2020, there are five emerging economies that are currently becoming the world powers, which are China, India, Russia, Brazil, and Mexico. The world's economic power will be more balanced by then.

Some of the implications of the economic conditions in 2020 can be estimated as follows.

1. Emerging markets have enormous potential. The population of developing countries far exceeds that of developed countries. For example, the combined population of Brazil, Russia, China, and India could reach around 2.8 billion people, while the combined population of developed countries such as the G7 countries is only around 700 million people. Thus, developing countries provide a huge market potential.
2. The large population will be accompanied by the growth of the upper middle class in developing countries. For example, the number of families with incomes above US$10,000 in China is expected to increase four fold from about 57 million families in 2010 to about 220 million families in 2020. This class requires both luxury goods and goods that do not fulfill basic needs alone.
3. The population in developing countries tends to be younger than those in developed countries. The proportion of the population under the age of 25 in developing countries is about 40% compared to about 27% for EU countries. A young population provides a market for goods such as household necessities, automobiles, and so on. In absolute terms, China and India will still have the largest over-65 population in the world in 2020.

4. With larger economies, developing countries have the potential to become foreign investors. Since the 2000s, China and India have become major foreign investors in Africa. Cooperation between developing countries has the potential to further advance the world.
5. With the increasing economic power of developing countries, their political power will also increase. China, for example, has become the third largest shareholder in the World Bank since 2010.
6. The economic development of developing countries can lead to negative possibilities, namely the acceleration of global warming and environmental destruction. Pollution in developing countries will increase as their economic growth increases.
7. The potential for economic meltdown in developing countries is also growing. The increasing economies of developing countries will further encourage the flow of foreign funds to these countries. This flow of foreign funds has the potential to encourage a 'bubble' (prices increase too high compared to their fundamentals), and has the potential to destabilize the country's economy. If something bad happens in the country, foreign funds will quickly flee the country, which can lead to a collapse in the country's financial markets' prices. This phenomenon is often referred to as hot money, where foreign funds can move in and out quickly.

What about the development of the world economy in 2050? A study conducted by an international accounting firm (Price Waterhouse) shows that China will be the country with the largest GDP in 2050, while Indonesia will be the country with the fourth largest GDP in the world. The GDP calculation made was based on GDP PPP (Purchasing Power Parity), which takes GDP into account after adjusting the cost of living in the country. Thus, although China nominally had a lower GDP than the United States in 2016, because the cost of living in China is lower than in the United States, China's GDP PPP is greater than the United States' GDP PPP.

Table 2.14
GDP Development of World Countries (2016-2050)

	Rangking 2016		Rangking 2030		Rangking 2050	
	Country	GDP	Country	GDP	Country	GDP
1	China	21.269	China	38.008	China	58.499
2	United States of America	18.562	United States of America	23.475	India	44.128
3	India	8.721	India	19.511	United States	34.102
					Of America	
4	Japan	4.932	Japan	5.606	Indonesia	10.502
5	Germany	3.979	Indonesia	5.424	Brazil	7.540

	Rangking 2016		Rangking 2030		Rangking 2050	
	Country	GDP	Country	GDP	Country	GDP
6	Russia	3.745	Russia	4.736	Russia	7.131
7	Brazil	3.135	Germany	4.707	Mexico	6.863
8	Indonesia	3.028	Brazil	4.439	Japan	6.779
9	England	2.788	Mexico	3.661	Germany	6.138
10	France	2.737	England	3.638	England	5.369
11	Mexico	2.307	France	3.377	Turkey	5.184
12	Italy	2.221	Turkey	2.996	France	4.705
13	South Korea	1.929	Saudi Arabia	2.755	Saudi Arabia	4.694
14	Turkey	1.906	South Korean	2.651	Nigeria	4.348
15	Saudi Arabia	1.731	Italy	2.541	Egypt	4.333
16	Spain	1.690	Iran	2.354	Pakistan	4.236
17	Canada	1.674	Spain	2.159	Iran	3.900
18	Iran	1.459	Canada	2.141	South Korea	3.539
19	Australia	1.189	Egypt	2.049	Philippines	3.334
20	Thailand	1.161	Pakistan	1.868	Vietnam	3.176

The table also shows that by 2050, developing countries will dominate the world economy. There are countries such as China, India, Indonesia, Nigeria, Pakistan, Vietnam, and others that are included in the 20 countries with the largest GDP in 2050.

C. MULTINATIONAL CORPORATION (MNC)

1. Characteristics of MNCs

A multinational company can be physically defined as a company that operates in two or more countries. For example, if an Indonesian company has a factory in Malaysia, it can be called an MNC. Today, it is not surprising that MNCs operate in more than 100 countries in the world, having several hundred branches and subsidiaries spread across hundreds of countries. The physical definition may not be so important. What is more important is the behavioral definition of MNCs. In terms of behavior, MNCs can be defined as companies managed by global managers, that is, managers who seek to optimize global resources, which is resources spread across countries. To illustrate, suppose there is an MNC that produces clothing.

Illustration: MNCs trying to optimize the world's resources

MNCs managed by global managers strive to optimize the resources available in the world, across national borders. Here is an illustration of a hypothetical MNC. Suppose there's an MNC that produces clothes. Here is a list of inputs used and where they come from.

Model/Fashion - Paris, who doesn't know Paris as the fashion center of the world? Clothing models are based in the city of Paris.

Cotton to produce fabric is sourced from China. China is the largest producer of cotton in the world.

Market - which country has the largest economy in the world? Probably the United States. With a population of about 300 million and per-capita income of about $40,000 per year, the US economy could reach $12 trillion in total. Compare that to Indonesia's economy in total ($1,200 times 250 million = $300 billion). The US economy is forty times larger than the Indonesian.

Labor - which country can provide cheap labor with good quality? China might be an option. With a population of over 1 billion people, China can clearly offer almost unlimited cheap labor.

Incorporated - where does an MNC list its company? Usually, countries with good infrastructure and low taxes are considered perfect options for listing. This includes legal infrastructure (clear laws and regulations) and technological infrastructure (good communication networks). Bermuda could be one of the options. The country does not impose personal, capital gains, or inheritance taxes.

Managers can be recruited from neighboring countries, such as the Philippines. The Philippines has a strong college tradition, thus their college graduates could be one of the options.

Machinery can be imported from Germany. Germany is known as one of the countries that produce reliable machines.

Funds - which country has the stereotype of producing cheap funds? Probably Japan. With a very low-interest rate, Japanese people still love to save. Interest in Japan was around 0.1% in 2010 and was the lowest interest rate in the world at the time.

The owners are Indonesians!!!

MNCs are an example of institutions that have developed by following and taking advantage of globalization. The growth of MNCs is partly due to the rapid development of technology, in addition to the changes in the world's social and political situation. Communication technologies and transportation are examples of technologies that will encourage the growth of multinational corporations.

MNCs thrive on the basic principle of mobile inputs. In the illustration above, the inputs of a clothing MNC are sourced from all over the world. Therefore, these inputs can be moved around easily. For example, machinery from Germany can be easily brought to China, when the textile factory is established. Funds from Japan can be easily transferred to Germany (to pay for the machines) or China (to pay for the labor). Technological developments allow such easy movement of inputs.

MNCs are often contrasted with David Ricardo's theory of comparative advantage (from the 17th century). David Ricardo, a classical economist, argued that countries should produce goods according to their comparative advantage. Then, countries in the world exchange the products they produce. This way, world trade will be established. World prosperity will increase. As an illustration, let's use two countries, Indonesia and the United States. What are the comparative advantages of Indonesia and the United States? Indonesia may have cheaper labor than the United States. The United States has a technological advantage, as their technology are far more sophisticated. Indonesia should produce goods based on its comparative advantage, cheap labor. Perhaps clothing as clothing does not require advanced technology, and cheap labor can lower the price of clothing. The United States should produce goods based on its comparative advantage, which is advanced technology. What product? Suppose a jet airplane. Jet airplanes require advanced technology. Then, Indonesia and the United States make an exchange. Indonesia sells its clothes to the United States, while the United States sells its jet planes to Indonesia. This will boost world trade, which will increase world prosperity.

It would be much better than if Indonesia produced jets or the United States produced clothes, as this would not produce optimal output. The way of working envisioned by David Ricardo is based on the basic principle that inputs are immobile. Thus, each country is destined to be a country with certain characteristics. Indonesia is destined to be a country with cheap labor, it can never be a country with advanced technology. The United States is destined to be a country with advanced technology.

The world's technological and social developments are putting the principle envisioned by David Ricardo aside. Technological developments have made it very easy for inputs to be moved around. For example, in David Ricardo's time, transferring money from Japan to Germany was a very difficult process. Money was put on a ship, which then sailed through Asia, made a detour in Africa (there was no Suez canal yet), and arrived in Germany a year later. Now the process of transferring funds from Japan to Germany is done by wire and only takes a maximum of one week. In David Ricardo's time, sending a design from Italy to China could take months. Today, the process of sending the design can be done through e-mail and takes no more than five minutes. Social development helps the development of MNCs, while MNCs also encourage social development.

The social development in question is the tendency to homogenize world culture. For example, today's standard workplace dress code is suit and tie. We see this dress code everywhere, both in the United States and Indonesia. Fast food has also started to spread around the world, both in the United States and Indonesia. We see fast food restaurants everywhere, both in the United States and Indonesia. In Indonesia, local versions of fast food are also developing, such as Yogya Chicken (fried chicken), and Mister Burger (burger).

The following example illustrates how MNCs develop international value chains to boost their competitiveness. The Limited, a clothing retailer based in Columbus, Ohio, USA, has about 3,200 outlets across the world. To accelerate its product cycle, The Limited uses communication technology. Through its head office, the company monitors which products are selling well. After obtaining this information, the head office sends orders via satellite to its factories in the United States, South Korea, Singapore, and Hong Kong. Once the products are completed, they are then shipped to Columbus, Ohio, USA, via a chartered Boeing 747, four times a week. In a highly automated distribution center, products are then sorted, labeled, and prepared for shipment within 48 hours. Then, by truck and plane, the products are delivered to The Limited's 3,200 outlets which are spread across the United States, Europe, along with its catalog products (direct-to-consumer sales). Within 60 days after the order is placed, the goods are ready to be sold in The Limited stores. This way, The Limited can shorten the order period to no more than three months, while other competitors usually take about six months. The Limited has better competitiveness in doing business this way. Transportation and communication technology are the keys to The Limited's management.

The following table presents the twenty largest MNCs in the world, ranked by revenue in 2018.

Table 2.15
Twenty Largest MNCs in the World

Rangking	Company	Revenues ($ milions)	Profits ($ milions)
1	Wal-Mart Stores	421,849	16,389
2	Royal Dutch Shell	378,152	20,127
3	Exxon Mobil	354,674	30,460
4	BP	308,928	-3,719
5	Sinopec Group	273,422	7,629
6	China National Petroleum	240,192	14,367
7	State Grid	226,294	4,556
8	Toyota Motor	221,760	4,766
9	Japan Post Holdings	203,958	4,891
10	Chevron	196,337	19,024
11	Total	186,055	14,001
12	Conoco Phillips	184,966	11,358
13	Volkswagen	168,041	9,053
14	AXA	162,236	3,641
15	Fannie Mae	153,825	-14,014
16	General Electric	151,628	11,644
17	ING Group	147,052	3,678
18	Glencore International	144,978	1,291
19	Berkshire Hathaway	136,185	12,967
20	General Motors	135,592	6,172

It can be seen that Wal-Mart is the world's largest MNC with approximately 421 billion US dollars as its revenue. Wal-Mart is a retail store company that sells various goods directly to consumers. Many oil companies are listed in the list, such as Royal Dutch Shell and Exxon.

MNCs operate based on the following principles (left column). For comparison, the world envisioned by David Ricardo, through his theory of comparative advantage, can be seen in the right column.

Table 2.16
MNC Working Principle vs Comparative Advantage

MNC Working Mechanism	Companies Under the Theory of Comparative Advantage
Inputs are highly mobile	*Inputs are unlikely to be moved between countries*
Raw materials from one country are moved to another country quickly.	A country is destined to be a particular country
Countries are able to learn new skills	Countries can only produce goods based on their comparative advantage
A dynamic principle.	Static principles
Countries can produce a variety of goods	

2. Motives of Multinational Enterprises

History shows that the growth of multinational corporations was not the result of systematic planning at the beginning. The growth is mainly generated as the response to utilize resources and opportunities that arise. A series of reactions to a variety of changing circumstances prompted the company to go international. For example, fierce competition at domestic level prompts the company to seek expansion outward, such as seeking cheap labor, and avoiding domestic competition. Then after succeeding in the foreign market, the company can further consolidate at the domestic level. Some of the following situations encourage organizations to expand overseas (go-international).

a. The search of raw materials

The motivation to seek raw materials is a classic motivator of overseas expansion. Colonization was primarily driven by the motivation to seek raw materials. The Dutch, with their VOC, came to Indonesia to look for spices. These spices can be used to warm the body and also to preserve food. In an era when refrigerators or fridges had not yet been invented, spices became a very valuable commodity. Today spices may no longer be a highly valued commodity, but many modern multinational companies have aligned themselves with the VOC. Companies like Exxon and Caltex are companies that seek raw materials (oil, in this case) abroad. Mining companies are also examples of companies that venture overseas for raw materials. These companies were pioneers in the growth of multinational companies. They began investing heavily overseas in the early 20th century.

b. *Market seeking*

The motivation to seek new markets currently dominates the growth of multinational companies. Multinational companies such as IBM, Unilever, Toyota, and Coca Cola, set up overseas branches or subsidiaries to boost their sales. When the Second World War ended, many US companies entered Europe to rebuild the Europe that had been devastated by the war. The flow of capital encouraged the growth of multinational companies. Multinational companies such as McDonald's and Dunkin Donut, entered Indonesia to utilize the large Indonesian market. Toyota set up a factory in the United States with the aim of freeing itself from yen-dollar exchange rate fluctuations, and thus ensuring a smooth supply of cars to the United States. An increasingly open world economy will further encourage this kind of motivation, which may result in competition between multinational companies and domestic companies. But with such competition or interaction, domestic companies are expected to behave like multinational companies, or in other words, to further encourage overseas expansion (go-international).

c. *Minimizing costs*

Multinational companies with this characteristic are deemed as the most recent phenomenon (compared to before). Multinational companies try to find places where production costs can be lower. For example, a textile company in the United States will not be competitive if it uses US labor as it might already be too expensive. To maintain its competitiveness, it might relocate its factories overseas to countries with cheap labor such as Indonesia or China. Many electronics companies manufacture their components in countries with cheap labor. Many components of IBM computers, Casio calculators, and Sony stereo systems are produced in Malaysia, Taiwan, and Indonesia.

d. *Other motives*

In addition to the motives mentioned above, many multinational companies expand overseas for other motives, such as gaining access to the world's technological developments. Many Japanese or European companies buy US companies or cooperate with US universities, with the aim of gaining access to the world's latest technological developments. Conversely, companies such as IBM have research divisions in Switzerland (Europe) for the same purpose. The choice of place or country, of course, depends on the technological advances one wants to follow. Besides the motivation of gaining access, many multinational companies expand outward with the aim of gaining security from political upheaval. When Hong Kong was about to be handed back to China, many Hong Kong companies transferred their shares or made investments abroad because they were worried that the transfer would have a negative effect on their companies. Many minority-owned companies in developing countries have invested overseas with the aim of gaining political security, in case of possible political upheaval in the country.

The motives mentioned above are not mutually exclusive, but complementary. Companies expand abroad not only because of one motive, but because of several motives at once. For example, Toyota or Sony companies expand to Indonesia with the aim of finding cheap labor in addition to wanting to take advantage of the potential Indonesian market.

3. Evolution of Multinational Enterprises

The presence of multinational corporations or overseas expansion does not happen immediately, but instead gradually. At first, the company identifies market opportunities that exist abroad, then exports goods abroad. This method has advantages because the risks faced by the company are relatively small, the preparation costs are low, and profits are received quickly. However, this method has disadvantages as it does not optimally utilize the foreign market. Once the company has a better understanding of the market, it can take further steps by setting up service facilities or establishing overseas branches. After further recognizing the overseas market, the company can establish a distribution center abroad. Then, after the distribution center shows attractive prospects, the company can increase its full presence by setting up overseas production facilities.

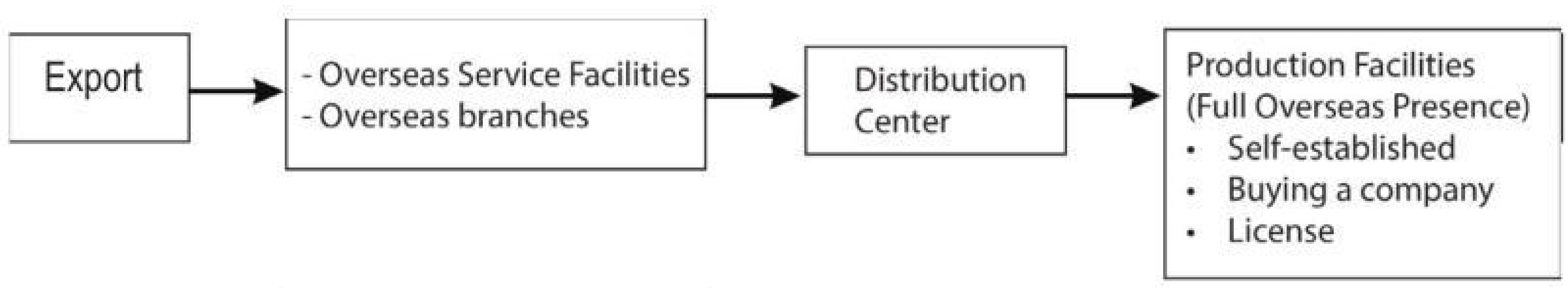

Figure 2.7
Evolution of MNCs

By setting up production facilities abroad, companies can fully utilize the foreign markets' potential. Of course, the risks involved will also increase, as well as the costs. This way, the company can quickly respond to foreign markets with a stronger commitment. The expected results are an increase in sales, which means an increase in profits, and stability of supply. The latter is especially beneficial for units that produce intermediate goods, which are then sold to other companies or to other units. Certain situations also turn overseas production into a necessity. For example, the United States Department of Defense (Pentagon) requires US military suppliers to set up factories in the United States.

The Pentagon does not want the supply of military weapons to be disrupted if production is carried out outside the US.

Overseas investment can be done by building your own factory or buying another company that has already been established. Each has their own advantages and disadvantages. Buying a pre-existing company has the advantage of a quick entrance into the market. This advantage is even more pronounced if the company is a late entrant into the market compared to its competitors. The disadvantages of this method include the possible difficulty of integrating the purchased company with the central company, in addition to the costs incurred which may exceed the cost of setting up a factory directly. Sometimes the situation requires a company to build a factory instead of buying an existing company. Companies with specialized production processes and equipment are forced to build their own factories to make them more or less consistent with the factories they have in their home countries. If there is no local partner, multinational companies are forced to build their own overseas companies. Establishing one's own factory has the advantage of flexibility and reduced costs compared to buying a company. The downside of this approach is the length of time it takes to enter the market. If competition requires speed to market, this approach becomes unattractive.

Another alternative to the two methods mentioned above is licensing. License is an agreement where the first party (licensor) grants permission to the second party (licensee) to use the brand and/or production process in accordance with certain agreements. The licensor receives a fee (payment) in return. The licensor will provide managerial and technical assistance to the second party. The second party must fulfill certain agreements, such as maintaining certain quality standards, purchasing certain materials from the licensor or a designated party. Of course, such method limits the flexibility of the licensee, and it is the weakness of the licensing method itself. The advantage for the second party is the assistance from the first party and an established brand or production process, which means a reduced business risk. McDonald's restaurants are a very popular example of licensing.

Exercise

To understanding of the material above, please complete the following exercise!

1) Identify and select one MNC company. Read the profile of the MNC (its products, the countries it operates in, the value of its sales, the composition of domestic and foreign sales, the size of its workforce, etc.).
   Show how the MNC is trying to optimize the world' resources.
2) Indonesia is expected to become the world's fourth largest country in terms of GDP by 2050. Do you agree? Explain the factors that might encourage or hinder Indonesia to become the world's fourth largest GDP by 2050.

Key Ideas for Exercise Answer

1) Search the internet for some information. There are many MNC companies that we must have heard of. Go to the company's website. Read the profile of the company and write the thing that shows the MNC-ness of the company (e.g. number of countries of operation, etc.), and also show how the company built its multinational operations (e.g. read the example of The Limited company earlier).

2) Search for information from the internet and other sources. Note the factors that can encourage or hinder economic growth in Indonesia, in particular. For example, factors that may encourage economic growth are larger population and higher education levels. Examples of factors that can hinder economic growth are instability, such as war, and political instability. Then after taking notes, make a more concise list, and evaluate it.

Summary

This learning activity discusses the topic of globalization. Globalization is currently an issue that is very relevant to management. The world today has practically entered the era of globalization, which is characterized by the narrowing distances between the world, the faster spreads of news from one country to another, and the less restrictions between countries. Globalization needs to be responded to with an open attitude, by being willing to open up and learn from other countries, and always trying to improve so that globalization can be an opportunity for companies.

The next section discusses the structure of the world economy, where the United States is still the world's largest economy (measured by GDP). By 2020, China is expected to become the world's largest economy. Between now and 2020, the global economy's changing structure will have several effects on business. The last section talks about multinational corporations (MNCs). MNCs are companies that operate in two or more countries. More than the physical sense, MNCs are characterized by the behavior of their managers who always try to optimize world resources (across national borders). MNCs are an example of organizations that seek to take advantage of globalization.

MNCs work on the principle that firm inputs are highly mobile. This principle is different from the views of classical economists such as David Ricardo. David Ricardo formulated the concept of comparative advantage. Countries should produce goods based on their comparative advantage. There are several motives for companies to go international such as looking for raw materials, looking for markets, and looking for technology. The evolution of MNC companies is gradual. First, the company exports. If conditions are more favorable, MNCs can go further by establishing sales offices and branches in other countries. The next stage, to optimize profits, MNCs can fully present themselves in other countries by setting up factories and establishing sales offices. The MNC will then be fully present in the foreign country.

Formative Test 3

Choose the correct answer!

1) The country that is expected to have the largest GDP in the world by 2050 is ....
   A. United States
   B. India
   C. United Kingdom
   D. China

2) The theory of comparative advantage between countries was proposed by ....
   A. David Ricardo
   B. Adam Smith
   C. John M. Keynes
   D. Michael Porter

3) By using the theory of comparative advantage of Indonesia against the United States, Indonesia has the advantage of cheaper labor, while the United States has the advantage of high technology. The products that should be produced by Indonesia or the United States are ....
   A. Indonesia produces jet airplanes
   B. The United States manufactures clothing
   C. Indonesia produces clothing
   D. Indonesia and the United States work together to produce jet airplanes

4) The characteristics of globalization include ....
   A. the physical distance between regions is getting narrower
   B. news between countries is increasingly difficult to obtain
   C. the transfer of capital between countries is getting faster
   D. the world community has a tendency to increasingly close itself off from external influences

5) Freeport, a US company. came to Indonesia to produce gold from gold mines in Papua, Indonesia. The motive of this MNC company is ....
   A. market-seeking motive
   B. motive to find raw materials
   C. motive to seek technology
   D. motive to seek security

6) The following is the working principle of MNC company ....
   A. raw materials are not portable
   B. a country is always destined to be a certain country, which is difficult to change
   C. technology creates a dynamic work situation
   D. managers focus on domestic resources

7) Here are some implications of the world economic development in 2020 ....
   A. the population in developing countries is older than that in developed countries
   B. the population in developing countries is smaller than that in developed countries
   C. increased economic power will lead to increased political power
   D. the number of middle class in developing countries will not increase

Use key answers for Formative Test 3 which is located at the end of this module to determine the correctness of your answer. To make sure your mastery of the learning materials use the following formula.

$$\text{Level of mastery} \quad \frac{\text{Number of correct answers}}{\text{Number of test item}} \times 100$$

Level of master is as follows

<70%	70% - 79%	80% - 89%	90% - 100%
lower than expected	adequate	good	very good

When you attain level of mastery 80% or more, very good, you may continue to the next module. Otherwise you have to review the material of Learning Activity 3. Pay attention to parts which you don't master yet.

Case
Meikarta Bribery and Indonesia's Licensing Dilemma[4]

Last Sunday (14/10), the Corruption Eradication Commission (KPK) conducted an official arrest operation against Lippo Group's Operations Director and Lippo Group consultants, Taryadi and Fitra Djaja Purnama, as well as the group's employee, Henry Jasmen. In addition to them, KPK also arrested the Regent of Bekasi, Neneng Hassanah Yasin, Head of Bekasi Fire Department, Sahat MBJ Nahor, Head of Bekasi Investment and One-Stop Integrated Service, Dewi Trisnawati, and Head of Spatial Planning of Bekasi Public Works and Public Housing.

They were arrested for an alleged Rp13 billion bribery case in the process of obtaining several permits required for the construction of the 84.6-hectare Meikarta project's first phase. Currently, the KPK continues to develop the investigation of the case. This Thursday, the KPK even searched the house of Lippo Group boss, James Riady. Urban planning observer, Yayat Supriyatna, assessed that the case, including the alleged bribery that befell the construction of the Meikarta project, occurred because there are differences in mindset between business actors and the bureaucracy in the licensing process.

To build a residential area like Meikarta, there are indeed many permits that have to be fulfilled. These include principle, location, Environmental Impact Assessment (AMDAL), land use utilization, and Building Permit (IMB). Each region, usually, has specific provisions related to building criteria, such as building height requirements and standards fire prevention safety. In some cases, local governments have not even regulated certain technical regulations for the construction of properties. This opens up opportunities for abuse of discretion by regional heads and related agencies. Businesses that want their project licenses to go through as quickly as possible and greedy bureaucracy often take advantage of this loophole.

Entrepreneurs who believe that time is money and do not want their projects to be obstructed might use dirty tricks to get their business going. It is understandable since in running a residential business, the longer it takes to run, the greater the costs they bear. Increased costs may arise due to loan increases. "Because the longer it takes, the more the loan costs continue to rise," he told CNNIndonesia.com, Wednesday (10/18). On the other hand, developers are also often bound by commitments and construction schedules with material vendors and consumers. Once delayed, their business reputation will suffer the consequences. Even so, the bureaucracy is indeed greedy. To get large sums of money by illicit means, the bureaucracy often takes advantage of these loopholes to manipulate entrepreneurs.

Indonesia Property Watch (IPW) CEO, Ali Tranghanda, said he wasn't surprised to see the Lippo Group's biggest project finally stumble upon a bribery problem. According to him, licensing issues are still a classic problem in the property sector of

4 https://www.cnnindonesia.com/ekonomi/20181018120313-92-339468/kasus-suap-meikarta-dan-dilema-perizinan-di-indonesia

Indonesia. Apart from complicated procedures, licenses are still far from transparent. Ali said that ideally, the licensing process for property projects should take no more than three months. However, in its practice, the licensing process in Indonesia can take more than three months, even years. "Business actors wish to speed up their licenses, but on the other hand, many licensing mechanisms aren't yet simple, which is why problems occur," he said.

Reformation

Due to this problem, both Yayat and Ali urged the government to make immediate improvements. Yayat stated that to prevent the Meikarta incident from recurring, the government should immediately issue a presidential regulation on the acceleration of detailed regional spatial and zoning plans' preparation. The presidential regulation is required to avoid a legislative void and the granting of discretionary authority to grant licenses in certain areas, which could be used by disreputable bureaucrats. In regards to developers, he also expressed the same appeal. Developers are asked to adhere to all existing regulations. Yayat pointed out that there are still stubborn developers who violate the rules in running their businesses.

Meanwhile, Ali asked the government to create a transparent licensing system to prevent the possibility of bribery. More importantly, he also asked the government to implement a strict monitoring mechanism. Currently, the online system that the government has implemented in several licensing processes isn't accompanied by a clear supervision mechanism. Improving the process will not only eliminate the loopholes of foul play in license processing, but will also make business competition in the property sector healthier. If we refer to the current practice, relationships with officials and the amount of facilitation money will greatly influence the success of developers in running their business in a region. "Local governments usually give permits to developers who they're already familiar with and typically large developers who are used to providing their 'services'. Without closeness, permit processing can be complicated and will take more time to complete," he said.

Discussion Question

If you, as the Meikarta manager, were faced with this situation, what would you do? If the manager follows the existing rules, the licensing process can take a long time, which might be detrimental to the company. If the manager wishes to speed up the process, the manager can offer "lubricant money" (bribe). But the bribe, besides being unethical, is also against the law. With such a dilemma, what would you do?

Answer Key to Formative Test

Formative Test 1

1) B
2) C
3) C
4) A
5) D

Formative Test 2

1) A
2) C
3) A
4) B
5) B

Formative Test 3

1) D
2) A
3) C
4) B
5) C
6) C
7) C

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