

BUSINESS ECONOMICS II.

László Tóth

SZÉCHENYI 



MAGYARORSZÁG
KORMÁNYA

Európai Unió
Európai Szociális
Alap



BEFEKTETÉS A JÖVŐBE

BUSINESS ECONOMICS II.

László Tóth



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Edited by:
László Tóth

Series editor
Lajos Kis-Tóth PhD, Professor

Reader
Husti István PhD, Professor

Authors
László Tóth

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1. INTRODUCTION

1.1 OBJECTIVES, COMPETENCIES

1.1.1 Preconditions to accomplish the semester

Objectives

Our contemporary economic systems are based on companies the utmost objective of which is to fulfil needs of consumers and to meet the requirements of the society while gaining profit and it is also essential for them to do their activities within legally sound structures. Business Economics is Social Science dealing with theoretical principles of the activity of companies in a multidisciplinary way, researching on motivation, causes of complex activities and examining their outcome. Companies working in economy are polychrome, their activity, structure can be examined in various contexts, therefore it is essential that Business Economics also approach this economic entity from various aspects. When examining companies it is indispensable to involve historical, psychological, sociological, legal, technical aspects as well besides other economic sciences as this is the way we can get more complex information about the institution having been present in the system of market economy for about one hundred and fifty years.

Business Economics is directly based on four pillars:

Microeconomics: We tend to accept the concept that man is somebody to react rationally, for his own interest. Besides this other motivations, features of real life man will also be described. In Microeconomics relationship of company and environment is an essential feature in their work, behaviour – and we accept this concept as well.

- Theory of contingency: According to this concept every single organisation is different, the main cause of which is that the relationship of certain structures to their internal and external environment is different. Different organizations have to cope with different (perhaps similar, but not identical) issues and find solutions throughout their activity.
- Relevance concept: The system of connections of the players of economy is dealt with as relationship of mutual dependance, which reveals that each intersection of this relationship net is of special importance in the economics system, it is only the difference of certain viewpoints, which emphasizes this or that

factor. Those players of internal or external environment are considered relevant which have long-lasting and essential connection with the company.

- Strategic aspect: Our viewpoint is inspected from the aspect of senior management since it is they who have great effect on productivity and effectivity of the company, also meaning that strategic approach is dominated in their negotiations.

Business Economics II. subject provides students with the following knowledge about modern companies:

- economic, social and technological processes enhancing their formation, concept of a modern company, essential characteristics and objectives of their activity,
- specialities of their management system, characteristics of their organizational structures,
- mechanisms of their coordination, also elements and features of their microenvironment,
- elements and features of their external environment,
- characteristic features of their innovation activity,
- objectives and activities connected to human resources,
- sources of their information, its role in their activity and essential features of information systems,
- managing value-creating processes, including features of production, service and material processes and also specialities of their internal and external logistics,
- objectives and tasks of their quality management,
- objectives and essential tasks of their financial and accountancy system,
- objectives to create strategy, guidelines of their strategy, tasks of strategy management, methods of elaborating strategy, elements of its implementation and check-up.

1.1.2 Competencies

To achieve targets of subject Business Economics II various competencies are to be acquired.

Students are expected

- to know social, historic, economic aspects of the emergence of modern companies, name players of company activity, main

- characteristics of the relations between them, elements of company objectives and system of their connections,
- to know basic concepts related to company management, connections between the various management levels and skills, know and able to characterise major organizational structures.
 - to know various coordination mechanisms, to know and be able to characterise elements of the micro-environment of the company,
 - to know and be able to characterise elements of the macro-environment of the company, be able to summarise features and dimensions of CSR
 - to know basic concepts of innovation, aspects of its groupings, to acquire elements of innovation strategy and aspects of innovation processes
 - to know concept, characteristic features of human capital, human resources management, to acquire elements, features of strategy and activities of human resource management,
 - to know concept and characteristics of individual and organizational knowledge, to acquire objectives, tasks of knowledge management, to be able to list and characterise construction and work of company information system,
 - to be able to group characteristic features of products and services, to know construction and work of logistics system,
 - to know role, history of quality assurance, to acquire concept, objectives and basics of ISO 9000, to know principles of TQM,
 - to know basics of the financial activity of a company, characteristics of financial strategy, operation of financial subsystem, to acquire types of investments and financing, their relationship,
 - to know concept of strategy, strategy management, importance, process, means of strategy planning, to acquire activities, methods related to developing competition strategies.

1.1.3 Conditions to accomplish the subject

Students can accomplish Business Economics II on condition that they

- know social, historic, economic aspects of the emergence of modern companies, main characteristics of the relations between players of company activity, elements of the company objectives and system of their connections,

- know basic concepts related to company management, management functions, connections between the various management levels and skills, know and are able to characterise major organisational structures.
- know various coordination mechanisms, know and understand correlation of the elements of the micro-environment and the company,
- understand correlation of the elements of the macro-environment to the company, are able to summarise features and dimensions of CSR (Corporate Social Responsibility),
- know basic concepts of innovation, aspects of its groupings, acquire elements of innovation strategy and aspects of innovation processes
- know concept, characteristic features of human capital, human resources management, acquire elements, features of strategy and activities of human resource management,
- know concept and characteristics of individual and organisational knowledge, acquire objectives, tasks of knowledge management, are able to list and characterise construction and work of company information system,
- know characteristic features of products and services, know construction and work of logistics system and its relationship to production,
- know role, history of quality assurance, acquire concept, objectives and basics of ISO 9000, know principles of TQM (Total Quality Management),
- know basics of the financial activity of a company, characteristics of financial strategy, operation of financial subsystem, acquire types of investments and financing, their relationship,
- know concept of strategy, strategy management, importance, process, means of strategy planning, acquire activities, methods related to developing competition strategies, understand relationship of company strategy and certain functional strategies.

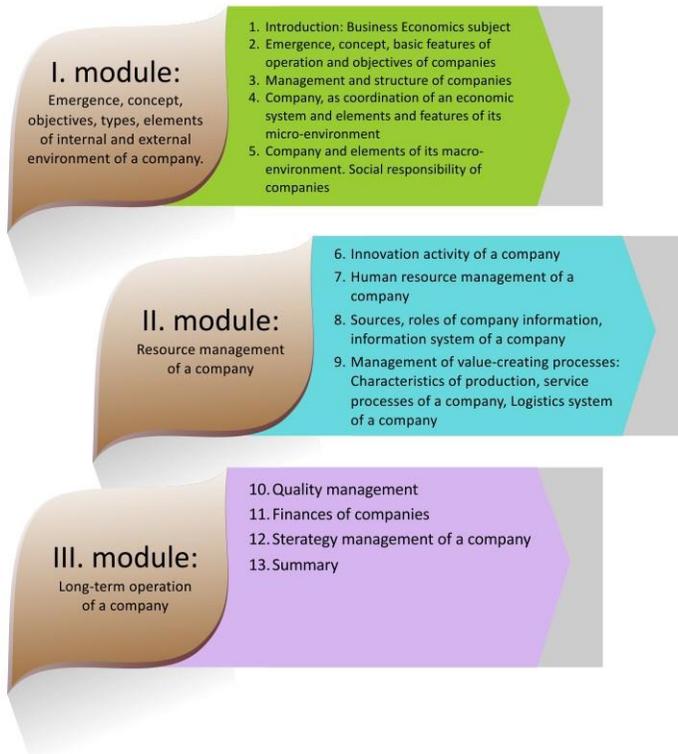
Content of the course (from 1 to 15) 2-13 basic material)

Business Economics II consists of three modules based on each other:

The first module gives information on emergence, concept, objectives, types, elements of internal and external environment of a company.

In the second module certain functional areas as scenes of resource management are introduced in a thematic way.

The last module deals with conditions of long-term activity of companies.



1. Figure: Construction of Business Economics subject

I module: Emergence, concept, objectives, types, elements of internal and external environment of a company.

1. Introduction: Business Economics subject
2. Emergence, concept, basic features of operation and objectives of companies
3. Management and structure of companies
4. Company, as coordination of an economic system and elements and features of its micro-environment
5. Company and elements of its macro-environment. Social responsibility of companies

II. module: Resource management of a company

6. Innovation activity of a company
7. Human resource management of a company
8. Sources, roles of company information, information system of a company
9. Management of value-creating processes: Characteristics of production, service processes of a company, Logistics system of a company

III. module: Long-term operation of a company

10. Quality management
11. Finances of companies
12. Strategy management of a company
13. Summary

In the appendix section at the end of the curriculum references, graphs, charts and media elements are collected. In the last chapter, Tests, there are exercises to enhance practising curriculum and to check how much they have managed to acquire the material.

1.2 ADVICE TO LEARN, INFORMATION

At the beginning of the units an idea-map helps orientation in the curriculum and understand methodical structures. At the end of the chapters there are self-check questions and practice exercises contributing to efficient acquiring of the curriculum and successful accomplishment of the subject.

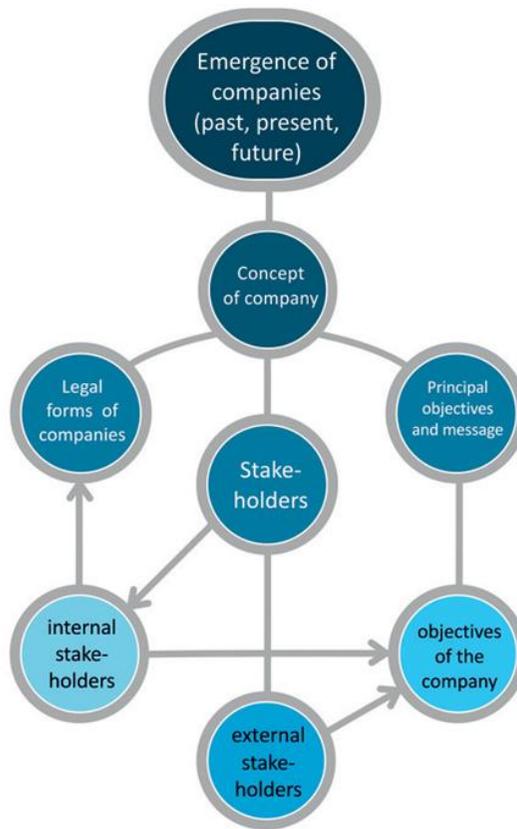
2. EMERGENCE, CONCEPT, BASIC CHARACTERISTICS AND OBJECTIVES OF COMPANIES

2.1 OBJECTIVES AND COMPETENCIES

Emergence of modern companies was based on social and economic changes as well as technical development until the middle of the 19th century. During the past 150 years these organizations of market economy have developed to the present structures through big changes, stages which can be divided into eras of development. A major aim of the unit is to teach students the most important stages of this development and position companies as elements of the social and economic environment surrounding them. To achieve this target students must know concept of venture, business entity and company and the main characteristics of their operation. They must be able to distinguish groups involved in the operation of the company, must know their main objectives, functions and elements of their correlation. Students must be well informed about the most important tasks of modern company management, must know structure and characteristic features of this subsystem. They must be well informed in grouping company objectives by different aspects, must know construction of a company by size and function and their correlation. Students must understand and characterise the most frequent legal entities.

2.1.1 Curriculum

In the first part of the unit we survey the centuries-old processes which have enabled development of modern companies, as legally and economically independent structures, the main objective of which is to meet consumer demands while gaining profit. Development of modern companies is shown in five, well distinguishable stages mentioning current tendencies and the ones of the near future. In the central part of the unit concept of a company, its main features and stakeholders involved in its activity are discussed. When examining internal and external players it is not only about the features of the certain groups but also about the complex correlation between them. Structures of the set of objectives and management are formed by the complex correlation of individual and organisational objectives which can be examined by various aspects. The unit focuses on grouping the set of company objectives by size, while characteristics of Anglo-Saxon company management will be shown in corporate governance. At the end of the unit legal aspects of concrete companies will be shown.



2. Figure: Formation, concept, basic characteristics and set of objectives of companies

When examining evolution of companies it is important to separate it from market economy, because emergence of companies preceded capitalistic economy. To explore origins of contemporary companies completely different social, economic and legal conditions must be evaluated from the ones of market economy. A major feature of the birth of companies from historic aspect is that their emergence was of dual direction. These directions are named upper and lower branches in professional literature.

A dominant factor in the emergence of the upper branch of companies was that at state organisations and settlements – in case of certain activities – a demand arose to fulfil various community functions in an efficient way. The units, founded specially for these purposes got, inherited the right, activity, etc. practised originally by the state or

community (e.g. village, town). This way the evolved activity frame was not identified with the participants but considered to have an independent existence. In these formations two important features of present companies can be recognised:

- a company insulated from the members (participants, founders),
- possibility to found a one-person firm (eg. the emperor, king)

The lower branch of company emergence was initiated by the wish for cooperation of the persons doing economic activity. To perform these activities skills, financial sources, partnership were needed among others, so during history various frames of cooperation were created. A name was given to their cooperation, however, these frames of activities were neither legally nor economically separated from the person who had founded it. Various forms of these cooperations emerged through the history. Development of companies continued with lower branch becoming dominant.

The history of the upper branch dates back to the ancient times where trade – mostly foreign trade – was usually directly supervised by the state. Therefore Assirian *karúm* (trade colonies) and Greek *empórum* were state institutions. Roman Law also recognised entity separated from participants, called *societas*, in case of activities deriving from the state. These societies mostly dealt with collecting road toll, operating silver- and salt mines. *Societas publicanorum* was born for state purposes (to collect tax) and was ceased by the state as well. In England companies directly connected to production, home trade were formed in 12th century (*craft guild*) and also *merchant guild* specialised in commercial activity. These societies were allowed to function only with royal consent. These firms had no private property, their name could only be connected to state privilege (royal consent).

During the emergence of the lower branch external risks had of great importance, namely bandits in case of trade by land and natural disasters in case of marine trade. Besides bigger investment was needed due to the transport of bigger and bigger quantity of goods. To accomplish a commercial trip one partner gave the capital and the other fulfilled the activity. That is how *commenda* emerged, similar to current partnerships (limited and unlimited members). In the 16th century share of the members of the society became transferrable in the assets of the company, that is how *joint-stock company* appeared. These companies had their own management and bookkeeping, that is the company became separated from its members. With emergence and development of joint-stock companies stock market and stock exchange came into being by the 17th century. Being a giant bubble speculation caused

economic panic already at the beginning of the 18th century and made obstacles for a century for joining the two branches. *Companies Act* enacted in England in 1844 made it possible for companies to get state acknowledgement in case of conditions meeting legal regulations. Registration/entry was the precondition of company foundation according to the act. After enacting *Limited Liability Act* in 1855 a lot of companies emerged and important companies had appeared by the end of 19th century. These corporations had no owners technically speaking and in economic sense either. The owner of the assets of the firm was the company itself, this *abstract economic entity* was liable for the responsibilities of the company. As dominance of the lower branch resulted in the emergence of the companies, individual (ownership) interests were more dominant. No wonder nowadays social responsibility of companies is a cardinal topic in their activity. Modern companies emerged this way are of triple determination:

- On the one hand investment decisions are completely separated from consumption decisions of the owners, which is the **principle of the economic independence** of companies.
- On the other hand the firm is an independent legal entity, has its own assets, this is the **principle of its legal independence**.
- A precondition of optimal function of a society is that its organizations, subjects play entirely the role assigned for them, it is the **principle of social existence**.

Age of the emergence of modern industrial companies (1850-1920)

At the beginning of the era production at companies was of minor size, so they were able to trade almost entirely at local markets, this way structures of companies were quite simple. One person or one group of people (usually family members) employed all the people and managed all the activity of the firm. The size of the companies was limited only by the fact, how many people the entrepreneur could personally supervise.

However, three important technological developments changed the contemporary conditions:

- steamboating made quick, scheduled marine transport possible,
- railway made fast transportation of people, goods and information possible on ground,
- spread of telegraph insured quick, borderless flow of information.

These developments together considerably reshaped contemporary industrial companies:

- Local markets grew to regional, national then international size.
- This caused increase in the volume of production, which meant that new, up-to-date production methods had to be introduced, specialised tools had to be developed creating this way mass production by the turn of the 20th century.
- Size thrift and technical development resulted in increase in the quantity of goods, improvement in quality, decrease in costs.
- Owners were no more capable of directly managing the companies having become larger and more complex, thus middle- and lower managers appeared. (Company hierarchy deepened.)
- For enforcement of property rights more and more refined bookkeeping and reporting systems were created so that investors and creditors get more relevant information and performance-based evaluation of employed managers became possible.
- The first cost calculating systems appeared which gave more precise information about production costs thus making it possible to measure profitability of various workshops, factories, products.
- Growing company sizes demanded bigger finance, so bond and stock markets and insurance business also developed in the USA.
- Finance problems were mainly solved by the emergence of giant banks in Germany and Japan.
- Market positions of local producers were endangered by other companies – often international ones – so local producers got united in trusts and cartels.

Various anti-trust acts were enacted in the 1890-ies, thus a major fusion wave started resulting in the creation of contemporary giant companies like Du Pont, General Electric, General Motors, US Steel. These firms mostly worked in functional structures and as holdings.

Multi-divisional company (1920-1960)

At the beginning of the 1920-ies General Motors diversified its range of products. Practically it meant that they produced more and more makes of cars and in more varieties. This way they had to alter its organisational structure in the way that it created different (relatively independent) divisions with their own, independent management and more decentralised decision making. Presently named Exxon (Standard Oil) integrated its activity horizontally (besides producing petrol they also made kerosene, lubricants) and vertically, too. The latter meant that

besides its crude oil refinery divisions it also dealt with crude oil extraction and crude oil research, creating separated divisions on these activities.

- The following years several large companies followed their examples, so divisional structure became the most widespread among large companies by the 1960-ies.

Multi-product company (1960-1980)

A major economic growth, increasing wealth was experienced in developed countries in the 1960-ies thanks to which income of customers, this way their purchasing power also increased. Companies wanted to meet this increased demand with even wider range of products and services. Giant companies of the beginning of the 20th century even at this time orientated on relatively narrow range of activities.

- ...Eg. Ford only produced cars and Gillette only blades. From the 1960-ies besides cars GM started to produce refrigerators, airconditioners, locomotives as well, and very often the material needed for their production, eg. steel was also produced by them. Companies at this time increased number of their activities not connected to each other. It was achieved by purchasing other firms, entering new markets. By the end of the period never-existed giant conglomerates were created with extensive parent-subsidiary company network.

Emergence of business associations (1980-2000)

Business associations were usually made between formerly totally independent from each other companies, usually when every company participating had special resources or skills missing at their partner.

- A good example for it is temporary association of Toyota and GM. GM expected from this association to get information about Toyota Producing System while Toyota hoped for creating a production base in the USA and wanted to get relevant information about North-American market. The cooperation was successful, Toyota sold more cars in the USA in 2009 than GM, and this latter having learnt Lean-production, gave up producing several of former GM brands. Formation and work of similar business associations can be seen in eg. aviation, car production, informatics.

Present and future of business entities

At the turn of the millenary – just like in the past 200 years –business entities continuously and steadily developed, took the possibilities of new challenges. Dismantled trade barriers gave way to new strategic and organisational opportunities which were creatively reacted on by companies, often encouraging spread of new technologies.

The most important current and future trends are as follows:

- *Change of technology in production*: in certain industries research and development based on modern technologies has become so expensive that market players are forced to create various strategic associations, eg. semiconductors, pharmacology, etc.
- *Communication and transport technologies*: internet has opened a completely new dimension in developing sales methods, technics, professional literature often takes container ships a major transport innovation in the 20th century.
- *Flexible production technologies*: spread of intelligent production lines (computer aided manufacturing - CAM), completed with modern transport and infocommunicational means makes mass individualisation – in case of certain products – possible meaning that eg. Toyota or Audi is able to fulfil very special needs of a customer in a perfectly tailored way.
- *Service industries*: here integration of ICT elements in financial services must mostly be mentioned.
- *Globalisation of economic activities*: faster and easier than ever has become mobility of people, products, information and also certain markets (product-, money-, labour market) have also become global.
-
- *Role of knowledge capital and knowledge management in a modern economy*: lifelong learning mobility in labour, creativity, demand for developing competencies, etc.

2.2.2. Concept of venture, business entity and company, players of company operation

Concept of venture mostly concerns way of thinking which involves motivation, skills of a person to be able to identify and perform activities

individually (or within an organisation) to create new values or achieve economic success.¹

People often get in touch with each other while performing activities in each field of their life, or these connections are fulfilled in certain cooperation. Saying in a different way people cooperate with each other to achieve a certain target or accomplish a task. These structures are called **organizations**. Organizations created this way always have a basic target which expresses the orientation of the organization and principles of its existence. There are different organizations, one aspect of grouping can be that certain organizations deal with producing goods to meet certain consumer demands. Household, as one of the economic organizational base units also falls into this category: produces economic goods for itself, within the frames of its own organization. If the organization meeting consumer demands performs this activity for business purposes (to earn profit) it is called **business entity**.

- ☐ There exist organizations which produce goods for other persons, groups (eg. charity organizations) but they do not do it for business purposes.
- ☞ **Venture: Way of thinking and the process of creating and developing economic activity combined with risk taking, creativity and/or innovation in a new or already existing organization.**
- ☞ **Business entity: Human activity whose basic objective, meaning of its existence is to meet consumers' demands in order to earn profit.**
- ☞ **Company: Organizational frame of a business entity having a legal person, a structure legally defined in modern societies in which activities to achieve basic target are performed.**

Their main characteristics are:

- A. **Self-sufficiency:** Capable of measuring circumstances from their own aspects, their decisions are based on it (self-sufficiency is always relative: determined by external factors)
- B. **Activity profitable on long term:** Results of their activity are summarised in financial reports and they aim financial gain. The

¹ Green Paper, Entrepreneurship in Europe, 21.01.2003., Brussels, 6.p.,
<http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52003DC0027&from=EN>

main target is profitable operation on long run, otherwise degradation, termination or loss of independence may occur.

- C. **Risk taking:** Precondition of profit is application of input (resources, availability of money). A venture is surrounded by instabil environs, outcome of economic processes may roughly be forecasted. An entrepreneur when investing at present does not know exactly if his expectations are fulfilled. The desired and the future outcome are not surely identical.
- D. **Challenges at a real market:** The input prices of a company (eg. costs of labour, price of raw material and energy, etc.) are determined at the input market while the price of goods produced by him are determined at the output market. Contrary to it works if they are determined by an organization, eg. state.
- E. **Legitimation:** Operation of a company within clear frames.
 - ☐ Company in Business Economics only means business entities having independent legal entity, legal person, it does not deal with private businesses and associations having no legal person.



3. Figure: The largest companies in the world by market value (2014)²

² Source: The World's Biggest Public Companies by Forbes May 2014
<http://www.forbes.com/global2000/list/>

The main objective and message of a business venture

Companies need two indispensable factors to achieve their fundamental goals:

- capital to be invested
- consumer demand to be met

📖 **Consumer demand: Demand met by the players of the economy not through work within their own organization and not through public institutions.**

- 📖 For example apple grown in the garden of the household or „free book” at school cannot be considered consumer demand.

Consumer demand is a rather complex notion, human **needs**, desires, wishes are behind it.

📖 **Needs is understood as set of goods and services considered important by a certain culture for maintaining human life.**

- 📖 Naturally these needs are greatly influenced by social conditions, however, their content is individually different.

Consumer needs appears on the market as **demand** and companies try to earn profit by meeting this demand. There are two conditions of appearing consumer needs as demand (these two conditions must be met at the same time):

- *willingness*: Consumers consider the given product or service useful from a certain aspect and are willing to pay for it to get it.
- *paying capacity*: Consumers own income enough to buy the given goods in the market.

The company wants to meet this solvent demand by offering goods and services at market prices and sales conditions. The company does this way a *dual value creating process through its operation*:

- on the one hand it must create value for the consumers who pay for it
- on the other hand it creates value for the owners of the company who invest money for it.

While basic target gives the principals of the company, the message of the company expresses the way how the company wants to achieve the basic target:

- What is the scope of activity of a company? (What solvent needs of what consumers does it want do meet in what way?)
- What internal operational theories are drawn for itself?
- What are the basic theories it builds its connections on with the persons, groups, organisations involved in its operation?
- Message of a company: Expresses the essence of the business, outlines the scope of its activity, differentiates it from other companies.

When implementing the message the company must perform different activities, two of which are indispensable for its existence and operation: marketing and innovation. Naturally dominant role in the life of the company is played by production (or service).

- 📖 **Marketing: It expresses consumer orientation of the company, and fulfils market connection developing and implementing functions of the company.**
- 📖 **Innovation: It means a new and higher quality meeting of consumer needs than before.**
- 📖 **Innovation activity is the result of market orientation of the company as a company operating in market competition conditions needs constant innovation not to lose its consumers in case its competitors offer eg. better quality, cheaper, etc. goods. Innovation makes it possible that the company can realise profit even at changing consumer needs and changing competition conditions.**

Stakeholders of the operation of the company

The objectives, goals of the company can be derived from the message of the company, goals of those involved in the operation of the company, based on which they determine the activities necessary to achieve these targets. This set of objectives is the basis to make various company decisions. The principle of involved-concept is that the company gets in touch with various other members, groups of social and economic sphere during its operation. These groups have influence on the operation, efficiency of the company and also these groups can get various advantages or drawbacks from the operation of the company, so when making decisions stakeholders' aims, functions must also be taken into consideration.

- 📖 **Those involved in the operation of the company (stakeholders): Every person, group or organisation who**

may have influence on the operation of the company and/or interested in its outcomes.

According to a general grouping stakeholders can be divided in two main groups: internally involved and externally involved ones. Certain persons or groups can have several roles, so the groups cannot be sharply separated.

Internal stakeholders

- ☞ **All the persons, groups, organisations who belong to the organisation, play different roles, have different aims and interests.**
- *Owners:* Their aim is to increase capital invested in the company, so their interest is to realise the biggest possible share of company profit as dividend.
- *Managers:* They are responsible for running the company, their aim is to implement various, efficient operations, to gain approval of the owners, to recycle the biggest possible share of the profit back to the company operation, and soon become owners.
- *Employees:* Their aim is to maximise their personal income, to improve working conditions and to get the biggest possible income with the least possible work. Job security is an important factor for employees (in its real meaning and also by gaining indefinite work contract).
- ☐ Certain roles mainly in case of minor ventures overlap, eg. in case of a private business all the three functions may be the same. Together with the growth of the company these roles become more and more different, their division is inevitable.

External stakeholders

- ☞ **It is set up of those persons, groups, organizations who do not belong to the company but have effect on its operation, and in some way are involved (interested) in its profitability as well.**

Closer (direct) environment

- *Consumer/customer:* Their value judgement/ satisfaction has essential influence on long term profitability of the company.
- *Supplier:* They ensure resource supply of the company, which is a crucial aspect of the operation. A reasonable business

relationship based on cooperation can ensure high level and stable resource supply for the company and fair profit for the supplier. Creditors of the company are also meant here as they also provide resources for the operation.

- *Competitors*: They partly have similar scope of activity, so they want to meet the demands of the same group of consumers. They are in mutual connection: share the solvent demand and make each other innovate constantly.
- *Strategic partner*: They are those companies, institutions whose message „overlaps“ the one of the company or they have partly similar objectives, activities. It can be manifested in eg. a mutual development, marketing campaign (horizontal connection) or in creating long term supplier/buyer systems of connections (vertical integration) where besides market elements strong and well defined organizational connections appear as well eg. investment in mutual logistics base. Theoretically any external stakeholder can appear as a strategic partner. The most important and most frequent is strategic partnership of companies, but also state-company partnership is important.

Wider (indirect) environment

- *State institutions*: Their role in the life of companies may change depending on the social-economic system of the country. When regulating economy both market and state take part in it in a modern society. It is important to emphasize that stakeholders do not mean abstract state, but they may be institutions representing state in its connection with the companies. Various state institutions have different effects on companies, which often cause conflicts due to contradictory or compulsory regulations to be considered.

Local and voluntary civil communities: Here can be mentioned institutions of local administration and all possible non-governmental civil associations: eg.: environment protection movements, organisations safeguarding consumer interests, religious communities and civil sphere. Local society is naturally of great importance for the companies since their direct environment is formed by it. The company has connection with local inhabitants as the company is not only a market player, but a social factor, an important organiser of local life as well. Local administration has a double role: it often makes regulations and informal influence (lobbying, overlapping) cannot be neglected either. At the same time interactions are also important: the company may contribute to solving social-cultural problems. Relationship of these organizations

involved to the company has been steadily improving in the developed countries.

- *Relationship to natural environment:* This area has been rather one-sided up to recently: companies exploited natural resources. However, the past two-three decades have brought big changes in this field. Realisation of restraint of natural resources from economic aspect, while growth of general social responsibility in developed countries from human and moral aspects have called the attention that companies should pay more attention to this relationship. Today it has become a requirement to sustain-regenerate natural environment. Natural environment is represented to companies by certain state and local regulations and also by environment protecting civil organizations.

2.1.3 Objectives of a company

Objectives of a company as organization generate from its message, from aims, objectives of the internal stakeholders. The chapter wishes to give answer what kind of aims internal stakeholders have and from these aims how company objectives emerge and how they can be characterised. When examining aims of internal stakeholders at first general aspects of the connection of individual aims and corporate (company) objectives should be focused on, then aims of certain groups involved should be dealt with according to their roles in the organization.

Individual and corporate aims

People have individual aims and they join an organization, take part in its activity because they think it can support them to achieve their targets. Motivation plays important role when setting individual goals and implementing activities.

- ☞ **Motivation: The word originates from Latin verb *movere* which means to move. Motivation is an umbrella term, built from motives and includes all the internal factors which make us act, behave in a certain way.³**

Characteristics:

- Members of an organisation are willing to act for implementing corporate aims if they satisfy their own personal needs as well.

³ ESTEFÁNNÉ, VARGA MAGDOLNA – DÁVID, MÁRIA – HATVANI, ANDREA – HÉJJA-NAGY, KATALIN – TASKÓ, TÜNDE: Theoric bases of psychology, E- learning study material, <http://old.ektf.hu/hefoppalyazat/pszielmal/index.html>

- Motives as promoters, inner impulses of human behaviour are to characterise inner state.

Motivation theory and model of Maslow

Needs are arranged in stages, in a hierarchic way.



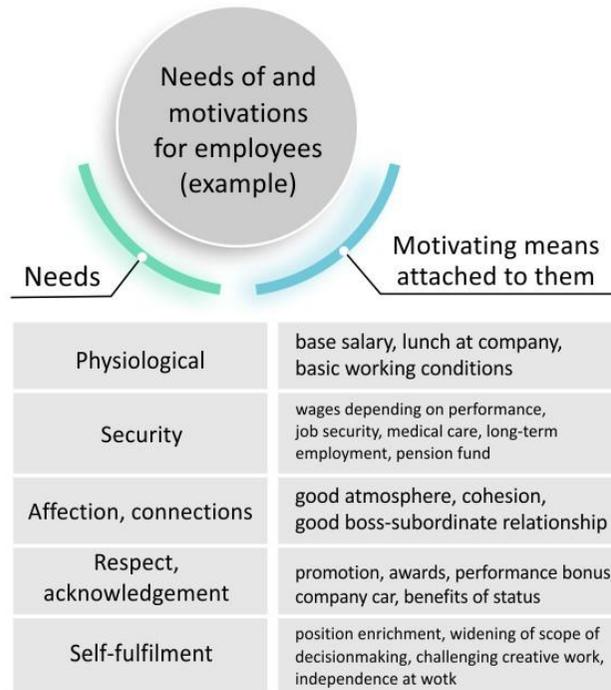
4. Figure: Piramid of needs (Maslow)⁴

Conclusions:

- Motivation is a very complex issue, not only one motivating factor acts at the same time or period
- Hierarchy of needs means that usually lower level needs are met first, before higher level ones start to act as motivators. Eg. if somebody has no clothes or is starving even the most interesting work will not have big motivation on him.
- There are many more ways to meet higher level demands than lower level ones.
- It is important for people to feel that they are needed. Everybody would like to be treated as individual. They must be given the possibility of responsibility.

⁴ Source: KOTLER, PHILIP: Marketing Management, Műszaki Könyvkiadó, Budapest, 1998., p.224.

 **Example:** Motivation levels and benefits connected to them at an imagined employee.



5. Figure: Needs of and motivations for employees (example)⁵

Relationship of needs and individual aims

A deed can rarely be originated from one single need. A certain action may be initiated by several needs at a time being though of different intensity. However, a certain need may not necessarily initiate the same action from different people. One may set substituting mock aims if meeting a certain need faces obstacles.

The aim chosen by an individual depends on 4 main factors:

1. Set of standards and values of a person
2. Inherited mental and physical abilities
3. Personal experience and readiness to learn
4. Mobility in physical and social environment

⁵ Source: own graph

Corporate objectives and their connections with individual aims

Organisations have their own objectives which are naturally not identical with the aims of the individuals building up the organization, but they are not independent of it either. Obviously there is no organization the members of which can completely meet all their personal needs.

Characteristics of corporate objectives:

- *They are structured in a hierarchic way:* The more complex an organization is the more it is necessary to structure them in hierarchical way – which is the task of the management. It does not of course mean complete integration: empiric examination of the arrangement and connections of corporate objectives may often be very complicated.
- *Mutual enhancement:* The organization and the members of the organization support each other in reaching their goals, that is individual aims advance fulfilling corporate objectives and vice versa. If there is no mutual support, the individual and/or the organization faces loss.
- *Compatibility:* Individual goals can be matched with effective operation of the organization.
- *Subordinated goal:* Common goal of all the members of an organization, to achieve it cooperation of the members is necessary, comprehensive enough to cover subordinated goals, or in another way saying: organizations exist because they are able to accomplish issues that people alone could not achieve.

The most effective organizations are those in which individual and corporate objectives can be matched as a result of a dialogue and compromise covering all the members. An organization can work effectively if the conflicts arising from the difference of goals are not oppressed by the management, but are handled by proper inner mechanisms. Combining individual and corporate objectives is one of the most difficult tasks of company management.

Goals and connections of internal stakeholders

When examining internal stakeholders it is assumed that their groups are homogeneous, however, in reality there may be big differences within a group and there may be overlaps between certain groups.

1. *Goals of owners:* They invest capital into a business to increase it. A precondition of it is the company be profitable. There are well separated groups of owners:

- A. **Natural persons:** They invest their personal property into the business, their relationship to the company depends on the proportion of their share, the two extreme cases of which are:
- *One person is the owner:* He has dominant role in the company, may give compulsory instructions to his employees and the management (if there is one).
 - *Listed company:* In this case there are several owners with relatively low proportion of shares, the names of whose are sometimes not even known. Owners can relatively quickly change due to sales – purchases of shares. One person has no direct influence on the operation of the company.
- B. **Corporate investors:** They take part in the direction of the company through representatives, proportion and way of their influence is determined by the legal status of the company and their share. They can have different types, the main groups of which are:
- the state and its institutions,
 - banks and investment funds, etc.
 - other companies,
 - social security and pension funds

☐ Naturally above mentioned groups are not necessarily separated in a company, but are characterised by a complex system of ownership. In globalised companies cross-ownership, common ownership, parent – subsidiary company connections may often occur, this way it is not at all easy to determine who is or are the real owners. Dominantly since the beginning of the 20th century mostly big companies have been directed by a management, so influence of the owners on achieving corporate targets is just indirect. As managers may have different aims due to their personality and function, it is not at all sure that they match the goals of the owners. A major question is how much managers represent interests of the owners? Professional literature calls this issue a representational problem.

☞ **Problem of representation:** It derives from so called **information asymmetry** between the owners and managers. Capital of the owner is functioned by a manager who has more precise information about opportunities of the company and available resources. Managers may use this extra information for their own purposes. Owners are helped by legal regulations in decreasing this problem (report, information responsibilities) and part of the income

of managers is given in shares according to the achievement thus making them owners and partly interested in ownership objectives.

2. *Goals of managers:* They are leaders of the company, whose connection with the company is the most direct of all the stakeholders, their decisions directly influence its current and future performance. Together with the growth of the company power, prestige of the managers also increases. Personal ambitions of managers often contradict to the ones of owners.
3. *Goals of employees:* Their personal aims are the least connected to the ones of the organisation, they do not even have direct effect on achieving them. They are mostly motivated by personal aims which may be varied, eg. sensible work, self-fulfilment, good team atmosphere, etc. They have natural clash with the above two groups. Employees would like the highest possible wages (salary), but this would mean cost increase for the company, and it is neither the owners' nor the management' interest.

Corporate governance

In the past decades the more and more increasingly globalised economy, advance of corporate investors, tendencies towards stronger and stronger social responsibility-taking of the players of the economy, the increased privatisation processes of the 1980-ies thoroughly have influenced questions of company management, so beginning from the 1990-ies issues of company governance have become topical.

- ☐ Malfeasance at several giant companies at the beginning of the 21st century (eg. 2001 Enron-scandal, 2008 Lehmann Brothers, etc.) has even more called the attention to these issues.

☞ **Responsible company management: Company management based on protecting the interests of the owners, business ethics, transparency.**

☞ **Corporate governance means joint company management where power is practised as a body based on cooperation with certain persons and groups.**

Its tasks are:

- to ensure gain of investors' assets in long term
- to respect demands and expectations of social environment
- to harmonise economic and non-economic targets

- competitive operation

According to these outlined ideas fundamental objective of the company has widened, besides satisfying customers' needs – in the same proportion – further issues have joined, so unlike the previous one it has become **managing trichotomy of market economy**.



6. Figure: *Managing trichotomy of market economy*⁶

Anglo-Saxon company management system and its characteristics:

In Anglo-Saxon system owners elect one single body for managing the firm, the Board, the most important roles of which are to:

- represent interests of the owners
- lead the company
- elect and control management
- elaborate objectives, strategies, company policy
- take responsibility for financial performance
- represent the firm and social responsibility
- make decisions in ultimate cases (eg. takeover)

Characteristics of the Board:

⁶ Source: ANGYAL, Ádám: Company governance, AULA Kiadó 2001., 24.p.

- it consists of 13-15 members, approx. 60% of which is not company employee, but insiders – experts coming from banks, insurance companies,
- it elects the Chairman
- they perform work of the directorate in committees, and have initiatives (and the Board usually accepts them).
- The most important committees are:
 - Executive committee is responsible for operational management and the head is the President or Chief Executive Officer – CEO who is usually the head of the directorate as well,
 - audit committee - to control financial performance,
 - finance and budgeting committee - to control financial processes,
 - compensation and remuneration committee - to assign bonuses for senior management
- ☐ Work of the committees are helped by several secretariates and teams of experts.

Objectives of a company

A major feature of company objectives is that it can be examined, arranged in several dimensions. One of the most common structuring theories is division by the volume of goals, which can be seen in figure 4. through its hierarchic character:



7. Figure: Purpose hierarchy of a company by the volume of objectives⁷

⁷ Source: CHIKÁN Attila: Business Economics, AULA Kiadó, Budapest, 2008., 52.p.

Construction:

- On the top of the purpose hierarchy are the two previously mentioned ones, purpose and mission deriving from it.
- When manifesting mission the company elaborates its durable, long-term objectives successful fulfilment of which is precondition of mission completion. They can be eg:
 - profitability
 - improvement of goodwill
 - achieving bigger market share, etc.
- On the next level direct managing goals can be found content of which is even more concrete, eg. goals connected to launching a product, changing an informatics system.
- At the bottom of purpose hierarchy there are operational targets which are the most concrete ones, eg. to purchase a certain material, produce a product, pay wages, sales

Characteristics:

- Precondition of achieving higher level purposes is to fulfil lower level targets
- certain goals can move within purpose hierarchy, depending on how much it is preferred by the management of the company

Objectives can be structured in other dimensions as well:

- *functional objectives*: they are outlined at various fields of the activity of the company, eg. marketing, research and development objectives, purchase, finance, production, sales, logistics objectives
- *objectives of internal stakeholders*: purposes of owners, management, employees
- *objectives of external stakeholders*: purposes of state, local government, environment protection, suppliers, customers, strategic partners, etc.
- ☐ In certain dimensions relationship of various purposes can be hierarchic (see: previous diagram), in other cases they can have horizontal connection (eg.: functional objectives)

2.1.4 Legal forms of operating ventures

A company can be defined as frame of a business venture where legal system of the given society assigns certain legally determined

structures in which they are entitled to operate. Various forms of associations are of very big variety all over the world, however, they are based on Anglo-Saxon pattern in developed countries, in Hungary as well. Different cultures, legal system, traditions, social political priorities determine the correlation of these legal structures in a given country. We will focus on the most frequent legal formations in Hungary.

Sole proprietorship and company

Proprietorships can be divided in two major groups according to their legal form:

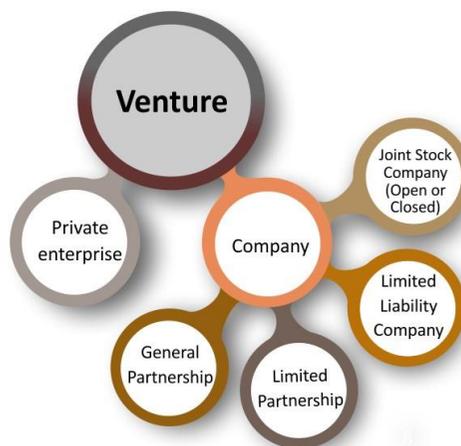
A. *Sole proprietorship:*

- ☞ **Economic activity of a natural person performed in his own name and at his own risk.**
 - He invests capital necessary for operating the business alone,
 - he makes decisions relating operation alone,
 - the owner is personally liable for every business responsibility (including all of his personal property) → *his liability is unlimited,*
 - he cannot involve other partners as co-owner → *ownership is undivided,*
 - he is liable for debt, bears loss, takes risk, does management alone.

B. *Association:*

- ☞ **A business activity of universitas personarum or universitas bonorum where partners share business results and responsibility of management.**
 - It has its own company name, it can get rights, take responsibility, gain ownership, make contract, start lawsuit,
 - it represents a peculiar privity of participants,
 - the owner creates organizational and management mechanisms separated from his personal property,
 - it is orientated to mutual economic activity and coordination through legally binding agreements,
 - they are of two types, as for the property of the venture is separated or not from private property of the owners:

- ☞ **At least one member of the association is of unlimited liability towards the venture, that is he is liable for the obligations of the company with all of his private equity.**
 - **Company and private equity are not independent**
 - universitas personarum
 - their types are *general partnership* and *limited partnership*,
 - financial contribution of the members is unbound.
- ☞ In legal sense the association is completely independent of its members, has its own asset and legal rights, so liability of the owners is limited.
 - Company-and private possessions are independent
 - universitas bonorum
 - their types are *limited liability company* and *joint stock company*,
 - asset contribution of the members is regulated by law (in case of ltd it is min. 3 million HUF, in case of private limited company it is 5m HUF, in case of public limited company it is 20m HUF)



8. Figure: Grouping of ventures by legal forms⁸

⁸ Source: self-made based on CHIKÁN, Attila: Business Economics, AULA Kiadó, 2008.

2.2 SUMMARY, QUESTIONS

2.2.1 Summary

In the emergence of modern companies mostly social, economic and technological changes took place besides many other factors. The objectives of a company as legally determined economic structure is of dual aspect: it is founded to satisfy consumer needs in order to gain profit. Recently these objectives are completed with the conception of social responsibility-taking of companies, through which company wishes to harmonise wider interests of society with its own operation. Its main characteristics are: independence, profit orientation, risk-taking and challenge on real market.

Factors playing role in operating the venture can be divided into internal and external stakeholders. The groups of internal stakeholders cover owners, managers and employees, their interrelationship can be characterised by both conflict and identity of interests. Part of the external stakeholders comes from direct market environment (customers, competitors, strategic partners, suppliers), while wider environment involves state and its institutions, local and voluntary civil communities and elements of social environment.

Complex purpose system is built up of the interaction with individual objectives of internal stakeholders and connections with external stakeholders, which can be examined in different dimensions. According to the volume of the objectives a company is of hierarchic composition, principals of its existence are determined by purposes on the top. Under it can be found message expressing operating theories, ways, activities of the company to achieve its fundamental objectives. The next level contains those durable, long perspectives in fulfilment of which also internal stakeholders are directly interested. Perspectives can be divided into direct management goals to be accomplished in medium term. On the lowest level can be found short-term operative targets.

According to ownership business ventures may have non-juristic person (general partnership, limited partnership) or juristic person (limited liability company and joint stock company) association formations.

2.2.2 Self-check questions

1. What do we mean by a modern company being triple determined?
2. Modern industrial companies emerged by what factors and how?

3. What are the current and future trends which characterise business ventures?
4. Describe the concept of business venture and company and enumerate main features of the latter one.
5. What does message of a company express and which factors are indispensable to fulfil it?
6. Describe the concept of internal and external stakeholders, their groups, objectives, their relationships with each other and the company.
7. What does company governance mean and what are its main tasks?
8. Describe the model of Anglo-Saxon company management.
9. Draw up and characterise purpose of a company by its volumes.
10. Distinguish juristic person company from non-juristic person one.

2.2.3 Practice tests

1. There are two preconditions of consumer need to be defined as demand: willingness for buying a product or service and solvency TRUE
- 2- In Anglo-Saxon system owners elect one single body to direct the company, the executive committee. FALSE
- 3 A sole proprietor is allowed to involve another person as co-partner into the business. FALSE
- 4 Company governance means that the government of the given country directs the company. FALSE
- 5 In case of an association with juristic person private possessions and company assets are independent of each other. FALSE
- 6 Associations with juristic person are business entities. TRUE
- 7 Corporate investors take part in directing the companies through their representatives, scope and way of their influence depends on the legal status of the company and their proportion of shares. TRUE

3. COMPANY MANAGEMENT AND ITS ORGANISATION

3.1 OBJECTIVES, COMPETENCIES

Paralelly with emergence of modern companies issues of organisation, management of labour also occurred and got to the focus of scientific researches about 100 years ago.

The most important target of the unit is to teach students the essential, basic elements and activities of structure design and operation. To meet these objectives students must be able to distinguish management and leadership aspects. They must be well-informed in the main tasks of managers of different levels and must be able to connect them to expected managerial skills. They must know managerial function types and content of management drawn up by Fayol. Students must understand managerial roles phrased by Mintzberg and aspects of Kotter on manager-leader model focusing on organizational productivity and efficiency.

Students must know the most important factors of emerging organizational structures, features, advantages and disadvantages influencing them. Students must be well-informed in structural features of organizations, must know related concepts and be able to determine basic types of

- division of labour
- delegation of authority,
- cooperation.

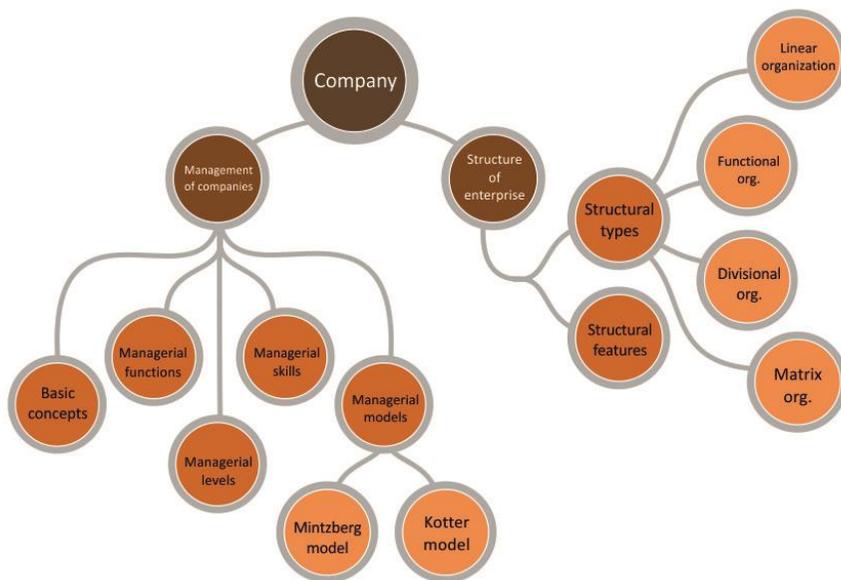
Students must be able to describe conditions of emergence, structural features of linear, functional, divisional and matrix organizational structures, their decisionmaking mechanisms, advantages-disadvantages and must be able to draw up the various configurations.

3.2 CURRICULUM

In the first part of the unit managerial and leader roles determining duality of managerial activity will be discussed. A most often applied dimensioning way of managerial activity is categorisation by managerial levels. This way tasks of senior-, middle- and lower level management will be reviewed and also skills related to them. Processes in connection with company management will be discussed according to the classification of Fayol: planning, organisation, direct command, coordination and control. Besides functional side of managerial work – recently – relation context has been attributed more and more

importance to as well, so it will be discussed by Mintzberg's managerial configurations (interpersonal, informational, and decisional roles). The manager-leader model of Kotter is considered interesting because it tries to integrate managerial and leader aspects with managerial process functions.

Evolving organizational structure of a company belongs to organization planning issues. In this context the most important factors of creating structure are analysed (degree of centralisation, orientation in space and time, task- vs. anthropocentrism, changing structures). After giving definition to structural characteristics of organizations (division of labour, delegation of authority, coordination) characterisation, configuration of the most important company organizational structures will be possible (linear, functional, divisional, matrix).



9. Figure: Management and organisation of companies

3.2.1 Concept of leadership

Leadership is an activity where human labour is sometimes invisible in everyday economic and social processes. However, human labour and managing, organisational issues of productive labour were not separated from professional knowledge of the given activity in the past. Attention of leaders was mainly focused on general problems of state, church, army and reign and government. Questions of leadership in organisation,

management of human labour have only got to the centre of attention of scientific researches.

Leadership is defined in literature by many and in different ways, definition of its content is understood differently even by renowned professionals, researchers of the topic. According to Angyal, Ádám (1999) concept of leadership has different approaches:

- Leadership is an activity where *objectives are determined*, and also *ways* and *methods, necessary to approach them*,
- the essence of leadership is *to influence people*, that is make them follow the way the management considers important,
- leadership may be considered *an altering activity*, through which favourable changes are encouraged to take place,
- leadership as work can be also taken as *exercising power*, where relationship of the leader and employees is considered determining,
- leadership in business life can be considered also as *science of successmaking*.

Expression 'leadership' has dual meaning in several languages.



10. Figure: Description of leadership⁹

⁹ Source: ROÓZ József: Principals of management, Perfekt Kiadó, Budapest, 2006., 18.p.

- ☞ **Purpose of management as controlling activity is to achieve successfully and efficiently the objectives of the organisation directed by them through proper planning, organisation, guidance and control of available resources. (the original meaning of English verb 'to manage' is 'to succeed')**



11. Figure: Managing activity¹⁰

- **Successfulness:** (external factor) means appropriateness of the created final outcome (eg. a new product). If the company manages to develop a product which meets the standards and managerial expectations, too, the company has worked efficiently.
 - **Efficiency** (intenal factor) shows effectiveness of the process creating the result. That is if the company used resources devoted to the development of the product economically, they have worked efficiently as well besides successfulness.
1. *If an organisation is considered to be a process to influence actions of a person or a group, it may be named 'leadership'.*

Leadership is a leader job the purpose of which is to make work of others – subordinates – successful. According to this aspect in the centre of leadership is man.

¹⁰ Source: NEMES, Ferenc: Managerial skills and methods, 2003., 10. p.

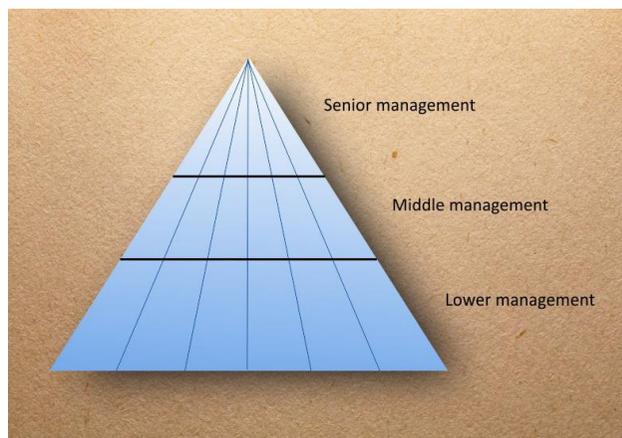
„Leadership is part of management and not the whole of it. Leadership is an ability to make people want enthusiastically to achieve set targets. It is a human factor which keeps the group together and stimulates them to move towards the aims.” (Davis, 1967)

3.2.2 Leadership activity and its functions

Leadership and activity of leaders can be described in various dimensions. The most widespread categorisation examines these activities as to what kind of functions are fulfilled by the leaders in the organization and what kind of knowledge/skills they must have for them. The above mentioned factors are closely related to „who are the leaders and where they are situated in the organizational hierarchy”.

Leadership levels in the organization

Division of labour is present in managements similarly to any other field of economic process. Specialisation of management is mostly visible at large organizations where different levels, units, departments, groups exist. Traditionally three managerial levels are distinguished at organizations (senior, middle and lower) and hierarchy can be described in the so called management pyramid.



12. Figure: Levels of management¹¹

¹¹ Source: KINICKI, A. - WILLIAMS, B.: Management A Practical Introduction 5th Edition, Published by McGraw-Hill/Irwin 2011., 17.p.

Tasks of senior management:

- To determine general purposes, strategy, politics, methods and guidelines of the organization,
- to represent the organization at its environment,
- to create, operate and shape organizational structure,
- to prepare, make and evaluate strategic decisions,
- to ensure resources necessary for the implementation of strategies.

Tasks of middle management:

- They are responsible for the implementation of targets determined by senior management, they elaborate methods, procedures necessary for the implementation of the strategy,
- they direct work of the organizational unit charged and fulfill the tasks they are allotted,
- they harmonise work of lower managers.

Tasks of lower management:

- They deal with operationalisation of medium-term plans, responsible for making effective decisions to fulfil customer-demands in appropriate quality,
- they motivate and direct work of their subordinates (responsible for implementation) with effective methods.

Besides vertical levels of management pyramid we can speak about horizontal classification showing the scope of responsibility of a manager. This distribution is called *management specialisation*, which has two branches:

- general manager:** the scope of his responsibility is to direct a certain subassembly, eg. a group of companies, company, subsidiary, division, factory, workshop, etc...
- functional manager:** the scope of his responsibility concerns direction of a certain function (group of activities) at the company, eg. marketing, R&D, production, sales, finance, logistics.

Managerial skills

Existence or lack of managerial skills may greatly influence performance. To be able to be efficient a manager must have sufficient routine in various skills. Combination of necessary skills may vary and of different orientation depending on certain managerial levels. The

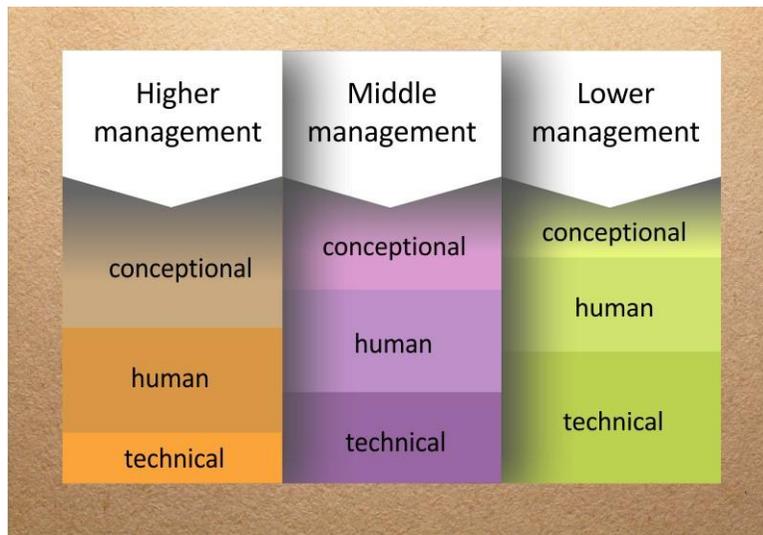
essential managerial skills applied at the certain managerial levels are divided into *technical* (professional), *human*, *conceptual* (strategic) skills.

- **Technical (professional knowledge) skills:** It means that the manager is capable of applying such determined knowledge, technics which may be indispensable to accomplish the various tasks. These skills, concerning work of the management, are of more importance at lower levels of the organization, however, it does not mean there is no need for certain technical knowledge, proficiency at higher levels.
- **Human skills:** A cardinal task of a manager is to find and apply right managerial style. Human resource is a key factor of an organization so it is essential for managers to be able to cooperate with their principals, colleagues, subordinates. It is generally accepted that role of these skills is of the same importance at any managerial level. The most important factors of human skills are:
 - *empathy*: empathic ability in situation of other people,
 - *communication skills*: ability to understand written and oral messages, negotiation skills,
 - *motivation skills*: ability to harmonise demands of the organization with individual needs of certain people (employees, subordinates),
 - *tolerance and apprehension*: accept others and otherness,
 - *educational development skills*: ability to teach, educate others.
- **Conceptual and strategic skills:** Conceptualisation means understanding operation of the organization as a whole and includes skills making a manager able to approach tasks in their complexity, understand causes, nature of events within the organization and in context between the organization and its environs.

Strategic skills mean ability to think in long-term approach.

The most important skills are:

- *target determining skills*: ability to choose the most effective way to implement tasks represented in the strategy,
- *coordination, scheduling, controlling skills*: ability to effectively combine various production factors,
- *time-management skills*: ability to utilise time efficiently,
- *comprehension skills*: ability to recognise and efficiently handle unexpected events.



13. Figure: Proportions of managerial skills¹²

Functions of management

When fulfilling his tasks a manager implements work processes – his activity is manifested in various ways of work – which being of complexity character, can be divided into functions, groups of tasks. These forms of labour are called managerial functions. Various aspects are known about division of management functions. Henri Fayol (1841-1825) French engineer, a classic of management theory made the following sequence of distribution:

1. Planning

☞ **It is an activity aiming at influencing future by determining concrete targets and to achieve them a concrete action plan is elaborated.**

☞ Efficient planning activity consists of the following decisions:

What are the tasks of the given organisation?

What must the organisation do to achieve the targets?

Who is responsible for achieving the targets, whose task is it to implement the certain steps?

¹² Source: KATZ., R.L. (1974): Skills of an Effective Administrator,, Harvard Business Review, 33(1), pp. 33–42.

What is the schedule and what is the way to distribute available resources to implement tasks?

When planning the following steps must be executed:

- To choose and fix targets (desired state).
- Thorough investigations and description of present state/situation based on which difference between present and desired conditions can be described.
 - Evaluation of differences, exploration of their causes.
 - Innumeration of factors contributing to and impeding achievement of targets.
 - To set up activities (alternatives) by implementation of which the task can be fulfilled and desired target can be achieved.
 - Evaluation of alternatives from different aspects, decisionmaking.
 - Implementation of the chosen alternative.

2. Organisation:

 **It is an activity aiming at the implementation of predetermined targets in order to harmonise (optimalise) human and material resources of the organization.**

Organisation involves 3 major groups of activity:

- Organization planning: creation and reshaping the organizational structure – it is mostly task of senior management,
- process organisation: harmonisation, structuring of organisation processes – it is mostly task of middle management,
- organisation of work: creation of the order of work, tasks to create certain jobs – it is mostly task of lower management.
-

3. Direct management:

 **A managerial activity which makes influence on subordinates in order to achieve targets of the organization through enhancement of commitment and personal example.**

In order to fulfil it:

- Employees having the appropriate knowledge and skills must be assigned with the right work-tasks,

- managers must be aware of the applicable motivation tools and their effects,
- targets and expectations must be revealed through two-way communication while calling the attention to occurring problems and demands,
- managers must be capable of creating and managing groups, teams to achieve the objectives.

4. *Coordination:*

- ☞ **It is an activity to coordinate, harmonise, correlate different units (functions) of the organization in order to facilitate the organization to work the most efficient way.**
- ☐ Differentiation of the units of the organisation is more and more dominant due to environmental changes and internal conditions, so it is necessary to coordinate the certain units in the interest of organizational objectives. Strategic importance of coordination activity has become important recently because organizations must meet more quickly changing, heterogenous external challenges, often in multinational environment, performing more and more diversified activity.

5. *Control:*

- ☞ **It is an activity to examine whether the activity of the company matches the plans, regulations, theories. This way managers continuously match targets with the results achieved and in case of difference they take the necessary steps to insure fulfilment or reshape the set targets.**

Controlling function consists of the following 4 elements.

- Performance standards which can be measured beforehand are set to the single activities, organisational units,
- these standards are checked during the controlling process,
- the results are compared to the standards,
- in case of critical difference between the features set in the standard and obtained intervention is implemented.

3.2.3 Managerial models

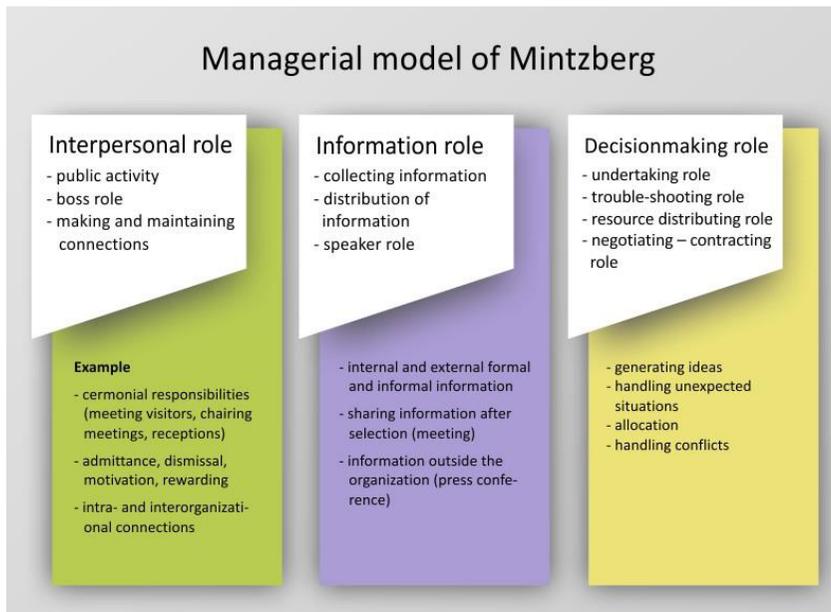
From among the great number of models available in literature the following two will be discussed:

Mintzberg model is chosen on purpose because the author wants to call the attention that currently, in the era of information- and knowledge

society managers), owning the relevant information, are increasingly characterised by functioning as braincentres of their organisation (business unit). The fundamental concept of Kotter model is that managers can make the organizational unit directed by them successful when applying a combination of manager and leader roles, both in the stable and volatile periods of their company.

Leader roles of Henry Mintzberg

According to this theory managerial work has a connection aspect as well besides the functional side (professional activity, tasks) towards various subordinate, superior and coordinated organisational units. While performing various organisational activities, different expectations occur towards a manager so that he can fulfil his decisionmaking roles.



2. Figure: Managerial model of Mintzberg

Manager-leader model of Kotter

Desired efficiency and productivity cannot be achieved without appropriate level of harmony in increasingly large size organizations of the 21st century. On the one hand leaders of the organizations must insure conditions of regulated, smooth internal operation, defined by the

author of the model as MANAGER role. However, challenges of continuously changing external surroundings (domestic and international competition, technological development, etc) force organizations for continuous alterations. Therefore such leaders are needed who recognise these changes in time and are able to give appropriate organisational responses for a successful outcome. This role is defined by Kotter as LEADER. In this sense leaders of organizations basically must perform two complementary roles (manager-leader) for the sake of successful and efficient operation of the organization.

Managers have 3 basic roles in the organization to cope with, which are understood and performed differently in their managerial and leader roles.

1. *Objectives - PLANNING*

- a MANAGER *makes plans* for different time schedules to achieve targets to which necessary resources are allocated
- a LEADER initiating organizational changes, however, *creates a vision of the future*, and to achieve it he sets up alteration strategies

2. *Insuring conditions - ORGANISATION*

- a MANAGER arranges conditions for implementing plans through organisation and with the help of human resource management (*creates the formal system of the organization*)
- a LEADER *gets people to stand by him* relying on his communicational skills by making them understand and accept necessity of changes. His personal validity is a great asset in it.

3. *Implementation - DIRECTION*

- a MANAGER „directs” subordinates with problem-centered attitude and help of control systems towards the desired direction, *checks them, makes them report*
- a LEADER *puts emphasis on motivation*, captivates his subordinates through their needs, feelings, skills in participative way so that they follow him to fulfil his visions.



3. Figure: Manager-leader model of Kotter¹³

3.2.4 Organisation planning – creating organisational structures

When discussing managerial functions organisation planning is mentioned as a major activity of organisation. The main aim of this activity is **that** a company create an efficient organizational structure – the best possible matching its environmental and internal features, also from technical, economic and social aspects it has sufficient stability and also flexibility.

Organizational structure can be influenced by several factors, the most important ones of which are:

Degree of centralisation:

- ☞ **It expresses to what extent does senior management delegate direction and control to lower managerial levels.**
- In case of strong centralisation direction and control shifts towards top management.
- In harder economic situations organizations tend to centralise, while in favourable external conditions they decentralise (similar is the situation in economic-politics: eg. in case of economic crisis

¹³ Source: PATAK, I Béla: *Technology management educational support*, BME ÜTI, Budapest 2013., 8. p.

stronger state control is typical in economy, while during prosperity market mechanisms gain ground).

- At smaller organizations direction is more centralised, together with the growth of the organization decentralisation demands increase.
- In case of certain organizational structures centralised and decentralised organizational units are present at the same time (eg. central units of a divisional organization, while the divisions operate in decentralised frame).

Advantages of centralisation:

- Coordination is easier if decision are made at clearly identifiable points of the organizational structure,
- top management has more comprehensive approach,
- bigger support is possible for certain organizational units, to insure balance of organizational units,
- general management costs are more rational,
- top managers make more effective decisions in critical situations (they are more experienced).

Advantages of decentralisation:

- It relieves senior management, thus it may decrease stress,
- participation increases satisfaction, commitment of lower level managers,
- helps in insuring new supplies in managers, it may result in bigger institutional flexibility, more effective control and performance.

A. Space- and time orientation of an organization

- An organization tending for efficiency mainly puts emphasis on sensible, economical utilisation of their resources, a main means of which is cost decrease. It often results in spending less and less on eg, research and development, trainings, education (according to short-sighted managers these activities do not generate income, just expences) this way they restrict their long-term possibilities and also do not catch up with tendencies in changes of the external environment.
- An organization tending for successfulness puts emphasis on opportunities for market sales of its products and services, therefore they often take senseless risks they neglect improvement of efficiency of inner operational processes.

Right combination of the two aspects can be advanced by various methods, eg:

- by rotation of jobs (people will have better overview on the activities at the organization,
- by helping intensive communication (they better realise, understand relationship between opportunities and resources of the organization),
- by giving preference to group work (teams, projects)
- by creating innovative organizational atmosphere.

Preference of task- and anthropocentrism in the organization:

In a task-centralized organization managers divide work into specialised activities, requirements are standardised (minimally expected performance is determined), individual evaluation is more dominant, a relatively deep (hierarchic) structure is created, at interventions position often overcomes professionalism, control is of great importance.

In a human-oriented organization jobs are of wider character (job-diversification = more interesting and varied work), more flexible hours, team work and common evaluation is favoured, permanent self-improvement, learning is expected, the organizational structure is relatively flat, commitment of employees to the organization is considered important, expertise is often more important than position.

B. Alteration in organizational structure:

Organizations operate the most efficiently in stabil environmental conditions, however, faster and more intensive environmental effects urge organizations to change their organizational structures, too. For the sake of their survival and growth organizations must push through alterations which give appropriate response to challenges of the environment. The ultimate purpose of the organization is to find balance between organizational changes and stability. During the past decades the number of factors forcing organizations to change has been growing eg.

- in buyer-seller relation the previous ones have got in more advantageous situation, companies have to fight for „the favour” of customers, that is balance of power has turned to the side of consumers, there is more and more oversupply on the markets.
- competition between companies is becoming more and more intensive, in several industries fierce competition is going on between globalised competitors, as for quantity, price and choice as well,

- change has become permanent supported by fast developing technology, life cycle of products and services is shorter and shorter,
- besides profit orientation several new motives (both internal and external) have appeared in company operation, like bigger expectations of employees towards companies, importance of environment protection, social responsibility of companies, etc.

Structural characteristics of organizations

Factors to describe organizations are called this way with the help of which operating logics of certain organizations can be studied.

Division of labour

- ☞ **By division of labour (specialisation) division of a bigger task-complex into sub-tasks and their allocation to certain organizational units is meant.**
- ☞ **Primary division of labour means that the most complex division of tasks coming from the basic operation of an organization is done by certain aspects , organizational subsystems are also created this way.**
- ☞ **Within primary division of labour there is a possibility to arrange subsystems by different aspects, it is called secondary division of labour.**

Specialisation is an essential arranging concept of organizational structures, usually functional, material-based or regional systems of division of labour are created.

- ☞ **If division of labour is done entirely by one of the above mentioned ideas, we speak about one-dimensional organizational structure. It is multi-dimensional if at least two of the above mentioned concepts are applied equally (parallelly) on the level of primary division of labour.**
- ☞ **Functional division of labour: When creating the structure homogenous professional activities are separated from each other in the organization and allocated to certain organizational units.**
- ☞ Eg. R&D – Research and Development, purchase, production, sales, finance

Material-based division of labour: units within the organization are created by homogeneous input-, and output groups.

- ☐ An example to the former one is when organizational units are created according to groups of products, to the latter one, when organizational division is made according to customer groups.

📖 **Regional division of labour: Activities within the organization are divided by homogenous geographical or sales regions and tasks are divided accordingly.**

- ☐ Eg. divisions in Sweden, Germany, France

Delegation of authority

Delegation of authority: Division of authorities within the organization means formation of managerial competencies of organizational unit by labour division concepts.

During this activity it is crucial that what is the system of the division of decisionmaking and directive authorities between certain hierarchic levels. Scope of the system can be centralised and decentralised as well.

Construction of an authority system basically can be of two types:

- A. *One-line system* means subordinated organizational units are only commanded by one superior organizational unit (connections of dependance and profession are not separated from each other).

Advantages:

sub- and superordination, competence and responsibility are unambiguous,
relationships are clear and simple,
hierarchy protects from others' misuse and intervention.

Disadvantages:

coordination tasks are a strain for superior units (their managers),
in case of substantial depth division route of command and information is long and circuitous,
there is personal dependance between superiors and subordinates.

- B. *Multi-line organization means* subordinated organizational units get commands from several superior organizational units (connections of dependance and profession are partly or totally separated from each other).

Advantages:

due to division of functions high level specialisation is typical,

routes of command and information are direct,
productive conflicts occur resulting in new solutions.

Disadvantages:

separation of competence and responsibility is problematic in full-company coordination activity,
impeachment for mistakes is difficult,
professionally based conflicts may indulge in personalities.

Coordination

- ☞ **Coordination: It means to coordinate, harmonise, correlate different units, functions of the organisation. Differentiation of organizational units is a natural demand coming from division of labour and jobs adapting to the constantly changing internal and external conditions, therefore the single units must cooperate in order to achieve mutual target.**

Coordination means of an organization can be divided into 3 groups (Khandwalla 1975):

- A. *Technocratic coordination means:* different regulations, plans, programmes, schedules, budgets, financial plans, etc.
- B. *Structural coordination means:* permanent or temporary organizational units are embedded into the primary structure to improve efficiency of coordination, such as staff, project units, teams, ad-hoc and permanent committees, etc.
- C. *Person-oriented coordination means:* these means are to encourage sense of identity of the persons with the organization, their aim is to build and strengthen consciousness of strong organizational values and organizational culture. Main methods are solutions to directly stimulate, focus, sometimes force individuals and groups and various psychological and ideological tools. When choosing a manager besides professional skills and managerial experience also his personality is an important aspect.

3.2.5 Types of organizational structures

Only the basic organizational structures are discussed

Linear (simple) organization

Aspects of its establishment:

- ideal organizational form for classical family or small enterprises

- relatively homogenous activity
- simple, not too complex, but changing environment
- charismatic leader

Division of labour

- division of labour is accidental, one dimensional (tasks of managers and subordinates are various and adaptable)
- there is no unambiguous regulated specialisation

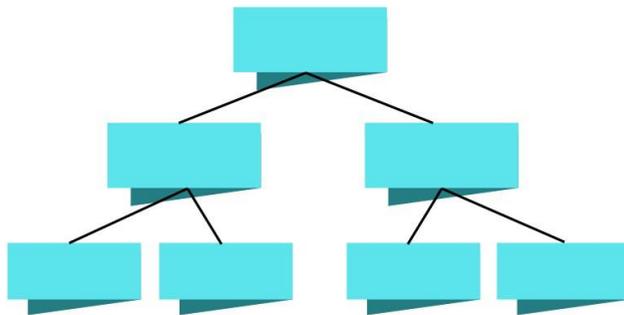
Delegation of authority

- very centralised (everything is decided by the boss)
- linear (business trips are typical)

Coordination

- done by personal commands
- random meetings, discussions
- no formal coordination means

Configuration



4. Figure: Configuration of a linear organization¹⁴

Advantages

- simple, clear-cut organizational structure
- units doing unnecessary activity fall out
- cheap to create and operate
- quick decisionmaking
- subordinate-superior relationships are unambiguous
- easy to enlarge

Disadvantages

¹⁴ Source: NEMES, Ferenc: Management studies and methods, Szent István University 2003.,162. p.

- new, different quality tasks are difficult to fit in the structure
- lack of specialisation increases the load of the senior manager
- horizontal coordination is difficult because of business trip
- problems affecting several units can only be managed only at senior level
- unflexible (new problems are often tackled by old methods)
- public relations are managed by the senior manager

Functional organization

Aspects of its establishment:

- relatively stabil market, science-technical, technological environment
- production activity is relatively clear-cut, range of products is not too wide

Division of labour

- primary division of labour within the organization is done by the organizational functions
- one-dimension organization

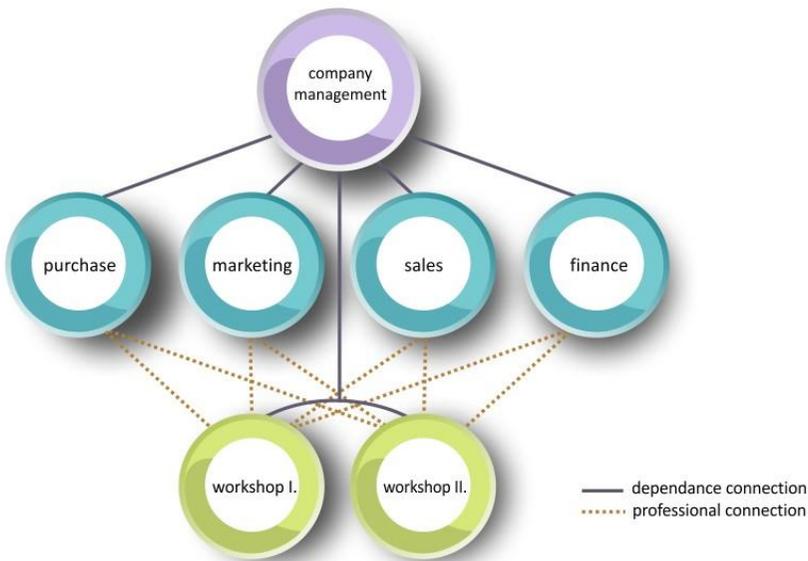
Delegation of authority

- Strong regulation is applied
- decisionmaking rights are centralised
- dependance and professional management are separated, a multi-linear organization is created

Coordination

- Characteristicly done by technocratic means
- channels built for vertical coordination
- coordination is done by horizontal teams, projects, committees and staff

KConfiguration



5. Figure: Configuration of a functional organization¹⁵

Advantages

- due to strong centralisation productivity increases, costs of production decrease
- due to strong regulation coordination costs may be decreased

Disadvantages

- unflexible structure of organization (new activities are difficult to include)
- function egoism (because of the strong separation the units of the organization and weak horizontal communication)
- the information connections are not clear-cut
- unnecessary surplus of stock both in quantity and quality
- slow adaptation to the quickly changing environment
- operativity is present at toplevel management as well, no time is left for strategy

¹⁵ Source: NEMES Ferenc: Management studies and methods, Szent István University 2003.,164. p.

Divisional organization

- ☞ **One-dimensional, one-line organization based on material or regional concept operating with relatively autonomous liability and report units.**
- ☞ **Division: Material or regional concept within the company, that is relatively autonomous accounting entity and responsibility center formed according to products (group of products) or customers (customer groups) or geographic market regions.**
- ☞ ***Aspects of its formation:***
 - wide range of products, heterogeneous products
 - large company size
 - possibility to create groups of products (groups of customers, regions) (low level mutual dependence)
 - relatively dynamic environment (strategic answer ability)

Division of labour

- primary division of labour by material or regional aspects (one-dimension organization)
- division of labour within the divisions is based on functional aspects (secondary division of labour)
- functional directing, controlling and service entities in the centre

Delegation of authority

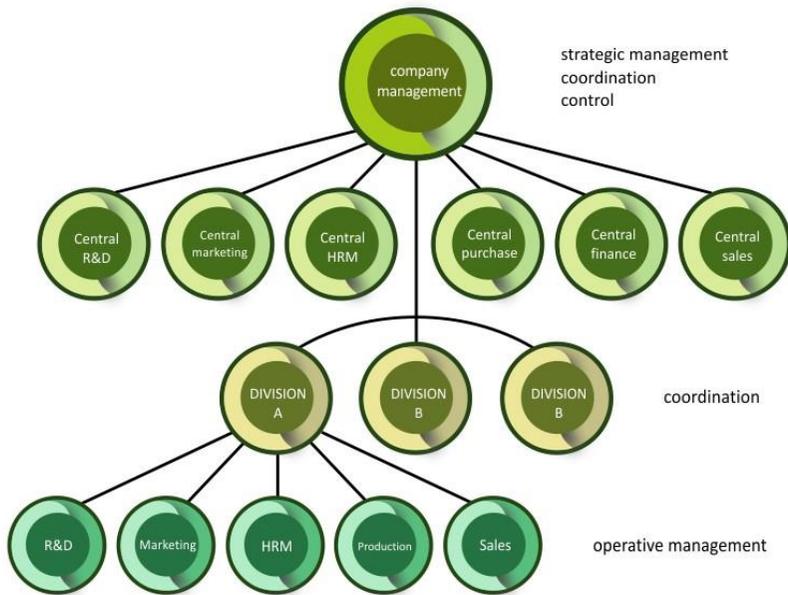
Decisionmaking rights are decentralised in the centre and divisions: strategic decisions are made by the centre and operative decisions by the divisions

- scopes of authority within the divisions are usually centralised
- one-line organization, within the divisions multi-linearity is possible

Coordination

- horizontal coordination is not typical between operative divisions, but vertical coordination of command character is also minimal
- technocratic means are dominant (finance- and controlling system)
- person-oriented coordination is of special importance

Configuration



6. Figure: Configuration of a divisional organization¹⁶

Tasks of the centre of a company

- clear separation of various activities of the company
- formation and cancellation of divisions (portfolio creation)
- distribution of resources
- elaboration of efficiency criteria and their control to check operation (performance) of the divisions
- to perform managing, coordination and control activities
- creation of central entities to support work of senior management and make use of synergies between divisions

Task and scope of activity of divisions

- **to prepare decisions of strategic importance** (strategy of the division, business and operational plan) concerning products belonging to the division (customers and market regions)

¹⁶ Source: DOBÁK Miklós – ANTAL Zsuzsanna: Management and organisation Formation and operation of organizational structures, AULA Kiadó 2010., 217.p.

- operational and administrative decisions related to the realisation of the strategy (business and operational plan)
- division leaders have their own development, purchase, production management and sales apparatus (generally a functional organization)

Advantages

- strategic and operational tasks can be separated
- clear target(s) can be set to the divisions
- strong market orientation
- fewer problems twisting over the whole organization (sectioning effect)
- low horizontal coordination costs
- liability- and interest sytem encouraging for good performance
- big supply of managers having general company management experience

Disadvantages

- integration of strategic and tactical-operational tasks is more difficult
- division egoism
- due to decentralisation number of staff is grown, parallel functions appear
- advantages coming from synergy effect are lost due to over-decentralisation
- lacks appearing in functional organisations are repeated at divisional level

Matrix organization

Aspects of formation

- dynamic (demnading structural reactions) and heterogen environment
- complex tasks with lots of novelties in the organization
- division of labour based on different aspects can be managed at the same time
- members of the organization have affinity to this kind of work in the organization (communicational skills, handling conflicts, etc.)

- the most typical industries: 2high-tech industries, construction companies, advisory firms, universities, marketing agencies, media businesses, research and development institutions, hospitals

Division of labour

- principally two equal aspects of division of labour (two-dimensional organization), one aspect is mostly functional, the other is material or regional
- intense regulation is not typical

Delegation of authority

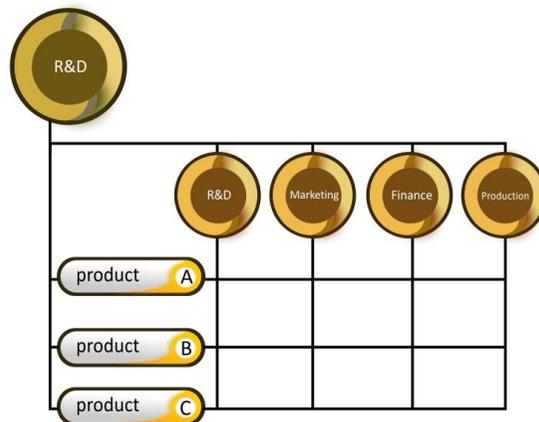
- managers of the divisions have equal (of the same weight) competencies, make decisions together
- centralised authorities besides multi-line directives
- low level of formalisation

Coordination

- person-orientated coordination mechanisms are of important role (choosing manager, culture, skills development)
- horizontal and vertical coordination built in the structure

Configuration (product oriented matrix)

Configuration of a matrix organization



7. Figure: Configuration of a matrix organization¹⁷

¹⁷ Source: DOBÁK Miklós – ANTAL Zsuzsanna: Management and organization, Formation and operation of organizational structures, AULA Kiadó 2010., 232.p.

3.3 SUMMARY, QUESTIONS

3.3.1 Summary

At the beginning of the 20th century emergence of modern big industry, mass production, growing sizes of companies more and more demanded more efficient company structures and productive managerial activity. No by chance have issues of company direction and management been discussed in science for about a hundred years. Permanently accelerating social, economic, technological changes keep this topic in the centre of interest even nowadays.

Aim of managerial activity is of dual direction:

- On the one hand to function the company as organization (system) successfully and effectively.
- on the other hand to make work of the organization productive.

Three different levels of management levels: basic-, middle-, and senior management are distinguished from hierarchic aspect. Managers working at different levels need certain competencies (technical, human, conceptual), abilities, skills, though in different proportions to fulfil their work productively. Work of a manager has been grouped by work processes (functions) as well. According to Fayol's division they are planning, organisation, direct management, coordination, and control. At present companies interdependence of certain areas is more and more dominant, so connection aspect has become important, too. Dual orientation and joining of functions of managerial activity is integrated in Kotter's manager-leader model.

Within types of organizational structures linear structure has been discussed which is mostly typical formation of small family businesses. Its division of labour is incidental, strongly centralized, one-line organization with not very specialised jobs. There are no formal means of coordination, it is usually functioned by personal commands.

A functional organization is of one-dimension, multi-line structure characterised by centralised decision making, regulation and technocratic coordination. Jobs are distinctively specialised, interdependence is strong between the entities.

Divisional organisation is characteristic of big company structures, it can be divided to a head organization and relatively independent divisions. Division of labour is most often done on material or regional basis, within the divisions functional approach is dominant. Strategic

decisions are made by central units operative ones by the divisions. In its coordination financial and controlling technics are of great importance.

Matrix organization is a dynamic, two dimensional, low level of formality structure, advantageous in an innovative environment. Person oriented means are of outstanding importance in its direction, conflict-handling technics are important in the management.

3.3.2 Self-check questions

- Distinguish the concept of management from leadership!
- What management levels are distinguished in organizations and what are their tasks?
- Describe the management functions of Fayol and their content!
- Describe management roles by Mintzberg!
- Innumerate and describe the most important factors influencing company structure!
- What are the features of organizational structures? Describe them!
- Draw up the configuration of a linear structure, describe its structural features, innumerate its advantages and disadvantages!
- Draw up the configuration of a functional structure, describe its structural features, innumerate its advantages and disadvantages!
- Draw up the configuration of a divisional structure, describe its structural features, innumerate its advantages and disadvantages!
- Draw up the configuration of a matrix structure, describe its structural features, innumerate its advantages and disadvantages!

3.3.3 Practice tests

- 1 General manager is a manager whose responsibility is to direct a subassembly eg. group of company, company, subsidiary, division, factory, workshop, etc. TRUE
- 2 Structural coordination means are eg. various rules, regulations, plans, programmes, schedules, budgets, financial plans. FALSE
- 3 In a functional organization primary division of labour within the organization is done by organizational functions TRUE
- 4 Aspects of creation of divisional organizations are relatively stable market, science-technical, technological environment and easy to see production activity and narrow range of products FALSE

- 5 In a divisional organization decision making is strongly centralised as for the centre and the divisions. FALSE
- 6 Division managers usually have their own development, purchase, production management and sales apparatus usually (a functional organization) to practise their scopes of activity. TRUE
- 7 A matrix organization is a one-dimension structure. FALSE

4. COORDINATION OF A COMPANY AS AN ECONOMIC SYSTEM AND ELEMENTS AND CHARACTERISTICS OF ITS MICROENVIRONMENT

4.1 OBJECTIVES, COMPETENCIES

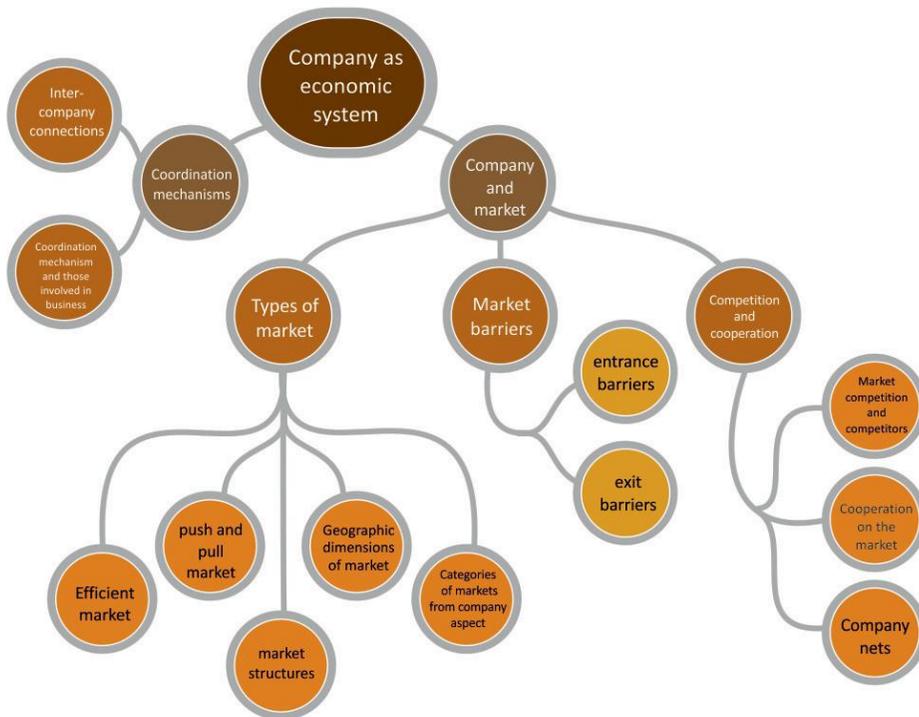
A principal task of economy as a subsystem of an economic system is to fulfil the theoretically unlimited needs of individuals and society by utilising scarce resources in the most possible effective way. According to the previously mentioned theory of contingency performance of an organization depends on its ability to shape its operation, activity, structure to the changes in the conditions of environment. The main targets of this unit are to discuss coordination mechanisms regulating cooperation of direct (market) environment and the company and description of the main features of these (mostly) market conditions.

In order to achieve these targets students must know concept of coordination mechanism, must be able to distinguish its main types. They must be aware of the concept and characteristics of transaction costs determining the limits of a company. Students must be informed of the main types of the connections of companies, must be able to characterise them. They must be able to innumerate those involved in the direct environment (market), their roles and ways of their interface to the company. The student must know the concept of market and its features: efficient markets, customer and seller market, market structures. They must be able to group markets by geographic dimensions and by the aspects of the operation of the company. Students must know limits of entering and leaving market. They must know concepts of competition and competitiveness, its main features and influencing macro- and microeconomic factors. They must be able to describe forms of company cooperations and company nets.

4.2 CURRICULUM

In the first chapter of the unit types of coordination mechanisms will be discussed. Market and organizational transaction costs determine limits of a company and determine main types of intercompany connections. In the next part market will be grouped by the following aspects: efficiency, push-pull market, market constructions, geographic dimensions. Examining conditions of entering a market is an important aspect for a company: this way barriers of entering and leaving will be discussed. In the last section of the unit business competition, concept of

competitiveness and reasons, features of the emergence of company cooperations and also specialities of company nets will be examined.



20. Figure: Company as economic system

4.2.1 Company as an economic system – coordination mechanisms

A principal task of economy as a subsystem of an economic system is to fulfil the theoretically unlimited needs of individuals and society by utilising scarce resources in the most possible effective way. Already representatives of classical economics said in 18th century that division of labour, specialisation of activities is indispensable to increase efficiency. Thanks to it people do their work with more routine and higher expertise, this way efficiency may grow. However, division of work needs **exchange of activities** and its **coordination**.

Main questions:

- ? How is harmonisation of the exchange of social activities, coordination done?

- ? How far can border of a company go, that is what determines what kind of activity they wish to do within the organization?

Coordination mechanisms:

☞ **Coordination mechanisms: System of principals and regulations directing the implementation of the exchange of social activities.**

☞ *Types (by János Kornai):*

1. In case of **Market mechanism** the players are equal, they contact each other voluntarily for mutual advantages, keep the rules based on mutual interest, these connections are made on financial basis.
2. Relationship of players in a **bureaucratic mechanism** is governed by subordinate and superior conditions. The ones at the lower level of hierarchy are forced for action by commands in legally regulated way and extent. The connections may be of monetary ones (the employees get wages), but not necessarily.
3. In case of **ethical coordination** the participants are equal, take part in the processes voluntarily. Temptation for it may be onesided (charity) or mutual, based on reciprocation, but money is not directly involved.
4. Participants of **agressive coordination** are not equal, because regulation is based on tough dominance of the „coordinator“. Money may appear in organised crime, too (mafia), but not necessarily. It is important to state that aggressive „regulation“ is not certainly illegal - the main aspect is that coordination, influence of the players is achieved through threat, pressure.

In social systems each coordination mechanism is present in bigger or lesser extent, but in modern societies market- and bureaucratic coordinations are considered the main mechanisms.

Different theories explain principals of emergence and operation of companies. In the following part *theory of transaction costs* will be discussed. The theory is based on the assumption, that coordination mechanisms make players of economy making connections possible within legally determined frames.

☞ **Transaction cost: Costs to create and maintain connections necessary to implement activity exchange.**

The theory is based on the assumption, that coordination mechanisms make players of economy making connections possible within legally determined frames. The economic organizations (eg. companies) tend to

decrease cost (transaction costs) of activity exchanges as much as possible.

Two final forms of activity exchange:

- **market coordination:** activity exchange is solved through sales contract, its means of coordination is price
- **bureaucratic coordination:** exchange of activities is done through commands (hierarchy)

If transaction costs are considered 0, then every transaction is done within market coordination (pure market economy). If transaction costs are excessively high, then every transaction is done within bureaucratic coordination (central plan economy). Optimal combination of market- and bureaucratic coordination emerges where market- and organizational transaction costs are balanced. Eg. if a company enlarges its range of activities up to the limit when transaction costs of the given activity to implement it within the company are lower than those of the market ones.

☞ *Several examples can be given to the above mentioned theoretical background, eg. canteen meals at a workplace. Let us take, that a company has one hundred employees who they want to provide with meal facilities. From among different possibilities two extremities are the following: One possibility is when the company orders meal from restaurants, from different ones, based on market condition. The other end is if they have a kitchen built to the dining room, so they solve meals themselves. In both cases transactions and their costs occur. In the first case restaurants must be looked for, negotiations take place, several questions must be agreed on. In the other case the company wishes to solve this activity within the company (entirely with bureaucratic means). A separated entity must be created with infrastructure, employees, wages for them, regulations, permits, etc. Obviously realization of both methods involve transaction costs, the company will choose the method which may turn to be cheaper on the long way. Naturally there are other possibilities as well, than these two. Eg. they can make a long-term agreement with a restaurant or order lunch together with other companies, etc. If they create a kitchen, they can deliver lunch to other companies, perhaps schools, public institutions, etc. Of course, the above ideas may be applied for several activities of company operation. Should it be arranged on market basis or bureaucratic (intra-company) or interim solution? Various fields can be mentioned, like accountancy, cleaning, raw material- or spare part purchase, maintenance of IT instruments, application of labour force, marketing activity, etc.*

The previous example showed that there may be numerous interim solutions between purely market and bureaucratic coordination. It is shown in the following figure:



21. Figure: Main types of inter-company connections¹⁸

- A. In case of **cooperation** players make agreements for longer term, for several transactions (eg. long-term framework agreement on transport, meaning that the supplier meets the requirements of the buyer by a certain timing, who will pay by a certain schedule).
- B. Within **strategic alliance** participants make long-term agreement on key areas, activities of strategic importance for the ones concerned, eg. mutual development, creating a mutual logistics center, mutual sales network, etc.
- C. In case of a **joint company** ownership rights are part of the agreement, eg. for joint sales they create a joint company.

Coordination mechanism and those involved in the company

Groups of externally involved may be attached to certain types of coordination. Groups of narrow environment: **buyers, suppliers, strategic partners, competitors** get in touch with the company through market mechanism, **the state and its institutions** represent bureaucratic coordination, while **civil organizations** and **natural environment** mostly show features of ethical coordination. Aggressive

¹⁸ Source: CHIKÁN Attila: Business Economics, AULA Kiadó, Budapest, 2008., 95. p.

coordination has just traces in modern societies (eg. segments of grey economy).

If those involved externally are grouped by the above way, then first it is practical to examine narrow environment of the company, embodied by market.

Company and elements of its narrow environment are connected to the market in the following way:

- Needs, wishes of **buyers** (consumers) become solvent demand on the market,
- **suppliers** provide resources to the operation of the company,
- **competitors** offer goods to consumers on the same market,
- **strategic partners** in cooperation with the company also wish to satisfy consumer demands.

The above list determines those roles which can be fulfilled by the company on the market:

- The company fills the part of a seller from the point of view of buyers,
- from the point of view of suppliers it is a buyer,
- competitors represent different interests on the market,
- interests of the company join the interests of strategic partners at some points, as they cooperate.

In the next part market and market conditions will be discussed.

4.2.2 The company and the market

☞ **Market: is a system of real and potential sellers and buyers and their exchange connections, the major factors of which are demand, supply, price and income.**

Already when determining their message the company assigns markets important for them:

- When answering „What to produce?” they decide on the market(s) they want to be present as seller.
- The goods to be produce obviously determines what resources they want to rely on, what market(s) they want to be present as buyer.
- Based on it also competitors are determined and circle of potential strategic partners.

Types of market

Market is a system of institutions to be categorised by different aspects, the major characteristics of which can be described in different ways.

. *Before deciding to enter a market it is indispensable for a company to answer the following questions:*

- What profit and expense relations can be expected?
- What are the market tendencies? (How efficient? Pull or push? What is its structure, geographic dimension like? etc.)
- How could market conditions be changed if they entered this market?
- What profitability and risk factors can be calculated with in short- and long-term?
- What entrance strategy to choose?

Efficient markets

Profitability is mostly determined by the fact how efficiently market mechanism works on the given market. It means that profitability of those activities and products grows where there is overdemand, while profitability of those areas decrease where there is oversupply. If overdemand is dominant, there is lack of the given products, prices usually rise, chances to gain income grow, which encourages profit oriented companies to enter this market or enlarge their activity here. If besides entrance to and exit from the market is relatively free, relative prices move following the changes of demand and supply and market players are informed about opportunities of gaining profit, then profitability conditions (that is returns rates of invested capital) in the certain industries tend toward equalisation.

- ☐ Thus more companies enter the attractive market, supply increases, price decreases, and similarly profitability. On a market which more companies leave supply decreases, price increases and profitability grows. In optimal case rearrangement of players go on at the different markets until possibility to gain income is equalised.

☞ **Efficient market: It is a market where returns rate of invested capitals are equalised fast.**

- ☐ In reality there is no „perfect” market, (it is most approached by stock exchange) companies face different risks in the different industries, eg. in case of investment involving higher risk they

expect higher gain. *When planning profitability extent of probable risk must also be considered.*

Push and pull markets

According to the theories of microeconomy market price is not necessarily equals with equilibrium price. In reality balance of market equilibrium exists only for short periods, since demands and/or supply is influenced by various factors therefore markets are usually either overdemanded or, on the contrary oversupplied on long term.

Markets where supply regularly exceeds demand is called **buyer, Push market** as buyer has dominance over the seller. In this case companies have to do bigger efforts so that buyers purchase from them and not from somebody else (advertisements, better quality, discount, hire purchase, constant development, etc.). The opposite case is called **seller, Pull market**. Developed economies nowadays are characterised by Push market, but in some cases it may turn opposite,

 *Think about the nuclear catastrophe of Fukushima in 2011 when car-industry suppliers stopped their production due to the disaster, so several Japanese car factories had to be stopped as a result of their tough time supply mechanism (JIT), this way car industry became overdemanded in respect of certain brands.¹⁹*

Market structures

The most simple categorisation of market structures is the following three (in Microeconomics there are further groups, too):

- In case of **perfect competition** there are very many sellers, share of one player is slight. Therefore one player cannot have real effect on prices, he can gain higher profit, than usual only by permanent development (innovation). Entering the market is very easy.
- In case of **oligopol** a certain product is manufactured only by few sellers who have very tough competition for buyers. Entering the market is rather difficult.
- In case of monopol market the product has one single seller and it is a favourable situation for him. It is impossible to enter this market.

¹⁹ [http://www.ma.hu/autohirek.hu/125722/Car industry has recovered in Japan](http://www.ma.hu/autohirek.hu/125722/Car%20industry%20has%20recovered%20in%20Japan)

Geographic dimensions of markets

Markets can also be classified according to the area they cover geographically (from administrative aspects):

A. Local markets: They are basic for small enterprises, for those involved role of local communities and state is dominant. A typical example is individual services eg. beautician.

B. Regional markets: They are essential for national economy policies, economy development concepts. In countries with developed infrastructure it often takes over role of local market, while in countries of big territory a regional market may represent certain features of national market.

C. National market is the level where market and economy regulating role of state meet the most dominantly. From financial market aspect this is the crucial level even in countries having convertible currency. Its separation from outside markets and regulation of their relationship is insured by several state measures, eg. identical legal system, customs, permissions, etc...

D International markets: Their significance has improved due to the spread of various forms of economic integration, certain functions of national markets have come over to this level as well (harmonisation of national economic policies, common institutional system, customs union). On international markets not only does competition of companies and products go on but also of national economic policies.

E. World market: Its real significance, outcomes of „globalisation” have been becoming topical only these days. (telecommunications, globalisation of information market, etc.)

Classification of markets by company operation

Classification by Business Economics is different from the one of Macroeconomics due to its peculiar aspects. From the aspect of company product-market can be divided into two main sections:

- **sales market:** The company sells products and services, that is exchanges goods to money (seller role).
- **resources market:** The company acquires different resources for its operation (buyer role), further elements of which are:
 - financial market
 - information market
 - labour market
 - information market
 - means of production market

- rawmaterial markets
- land market, etc.

Characteristics:

- A dominant feature of market economy is that market regulates not only distribution and exchange of goods and services, but also resources used for their production.
- Market creates possibility of rational decisions by prices functioning as common ground with the help of which different expenditures can be compared, profitability and efficiency can be measured.
- Market mechanism and market economy assumes existence of above mentioned submarkets which are together present in market economy, they are combined, rely on each other. .
- The company does not operate on these markets as a homogeous entity, but both the ones involved externally and internally have complex, multilevel relationships.
- From among internally involved:
 - managers have direct connection with all types of market,
 - owners are mostly participants in the capital and information market (they hardly have any connection to goods- or labour market),
 - employees mostly get into relationship with labour- and information market (perhaps goods market), they do not have any connection with capital market,

Entrance to the market

When creating the message of the company the principal interest of the company is to determine exactly the segment of the market the demand of which they are able and willing to satisfy through their operation.

- ☞ **Relevant market: The whole of those submarkets which may really match demand-satisfaction tendencies of a given company.**

We have grouped three different ones:

- *goods market division*: Those products are considered to belong to the same market which can easily be replaced by each other. From buyers' apect it means almost identical way of usage, quality, price, while on the

producers's side it means similar technology, expenditure.

- *geographic division*: It shows the geographic region within which the company is ready to satisfy the needs connected to the given goods.
- *division by groups of buyers*: The company determines potential buyers and important parameters concerning the product by certain characteristics in the given geographic region: eg. income conditions, age, gender, etc.

Entrance to the market naturally depends not entirely on the decision of a company, but it may depend on the aspects of the others involved, so considerable obstacles may hinder its success.

Barriers of entrance to the market

New entrants bring new capacities, wish to get a share from the market often by changing the existing conditions, this way it is not the interest of companies already present on the market to let new ones enter. In certain cases it is the state interventions which set barriers in the interest of the public.

- A. *Factors of state regulations*: With its regulations it can restrict, hinder, but also support entrance of a company to the given market.
 - strict health regulations may increase capital requirement, eg. animal husbandry
 - determining technology requirements, eg. mining
 - approach to purchase and sales channels, eg. weapon manufacturing
 - loans subsidised by state
 - role of export reduction, duties
- B. *Size economy*: The topic covers two important issues. On the one hand the entering company must decide on the minimal size (production output) with which they will be competitive on the new market. The other question is what reaction this extra amount of goods will elicit from the competitors already present on the market. If the planned market share of the newcomer company is slight compared to the market, there will not be big reaction. However, if the entering company needs substantial market share for efficient operation, competition will increase and overproduction, price decrease, market rearrangement may occur.
- C. *Product differentiation*: Companies having already been present on the market for a longer time can achieve consumer loyalty by

branding, developing brand stretching. The new entrant must make customers believe, must prove that his product is better than the acknowledged product of the competitors. Very often it is a big challenge for new-comers in the market of beauty-, pharmacology-food- or recreational items industry.

- D. *Capital barriers*: To set up a business owners have to deposit capital depending on the scope of activity. Difficulties in obtaining capital may depend on several factors: own capital of owners, possibilities to involve outside sources, costs, obtaining necessary technology, etc. In some cases capital barrier makes almost impossible for new players to enter eg. processor manufacturing, car industry, nuclear energy, airplane production, etc.
- E. *Costs to change partners*: Changing suppliers or retailers may result in substantial extra costs until cooperation with the new partners functions smoothly.
- F. *Approach to new channel of distribution*: Companies already present on the market own well-built commercial channels joining to which or building a new network may mean difficulties for the new entrants. It may be a special difficulty if there are exclusive brand distributors on the market, or other contract makes participation in the change impossible. On the purchase market there may be exclusive suppliers which cover all the order contingent of certain big companies, so they do not have any free capacity left.
- G. *Other entrance barriers*: Companies already operating on the market may have other advantages besides the above ones: licenccel, avagy más módon védett termékek, technológiák, alapanyagok
- advantages coming from favourable geographic location, eg. mine, terroir
 - skills of employees, purchasing-, production-, sales experience, better knowledge of the market may also mean advantage
 - hostile approach towards newcomers may also hamper situation of new-comers

Barriers of exit from the market

When a company is considering entering a given market, they also must take into account the possibility that his aspirations are not realised. In this case they had better leave the market, than work with loss or little profitability. However, exit from the market is not always simple because of several obstacles. The causes of the problem may be the following:

- A. **Specialized tools:** liquidation value of special equipment (mostly built-in properties) characteristic for the given industry may be very low, or relocation, remaking costs are too high.
- B. **General costs of exit:** we can mention here the costs coming from trade union agreements (eg. redundancy, etc.), maintaining production of spare parts, etc.
- C. **Strategic issues:** problems of sharedly used properties, difficulties in getting to money markets, etc.
- D. **Moral barriers:** commitment of the management to the industry, emotional issues overcome rationality, managers are afraid to lose their position, career, etc
- E. **Restrictions from the state and society:** constraints of economic policy (eg. long-term activity is precondition of state subsidy, however, in case of changing economic climate worse the company is obliged by the agreement, they cannot „skip“).
- F. Lack of convertability of human resources: in case of leaving the market workforce is not easy to change.

4.2.3 Competition and cooperation on the market

Besides customers also competitors and strategic partners are parts of external environment, so the latter ones are dominant elements of the set of connections of a company, too. The following parts show relationship, role of these two players to the company.

Market competition and competitors

Basic initiator of market is competition of the participants, which is dominant in the harmonising process of supply and demand. Market players are surrounded by a special atmosphere of the competition in which they compete – utilising possibilities, features of supply and demand – to achieve their own targets. In economic theory great importance is attributed to competition which plays indispensable role in the organisation of production, in determining prices and revenues. „ In economy competition is not autotelic, but a means of tendentious organisation of economic activity. Economic importance of competition mostly is that it makes players of economy produce cheap and good quality goods.” – says Stigler (1989)²⁰ In the formation of the rules of competition of market economy the following social, economic factors have played or play role:

- Technology requirements and possibilities,

²⁰ STIGLER, GEORGE J.: Market and State Regulation, KJK, Budapest, 1989

- market players, both those supplying and those demanding,
- legacy makers and applier (parliament, government, ministers, judges)
- competition regulators (eg. competition authority, commercial committees),
- departmental regulators (financial, telecommunication, transport, energy, etc.),
- market organizations, institutions (eg. stock exchange, service- and user associations),
- non-market organisations and institutions (eg. legal aid associations),
- moralities, habits, traditions.

☞ **Competition: activity of two or more players within given regulations aiming at profit-making over each other.**

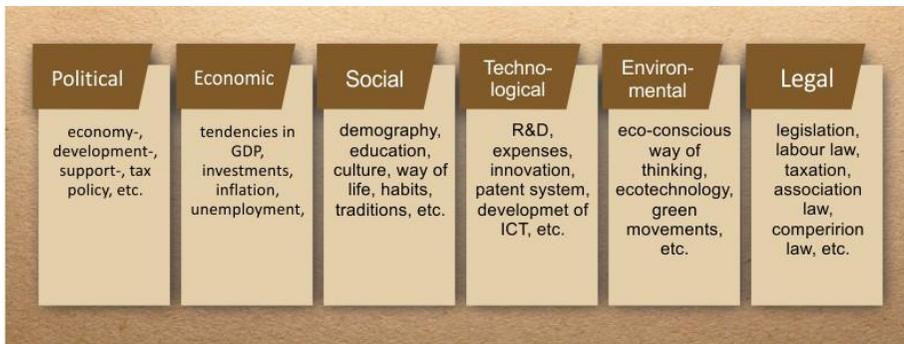
Characteristics:

- Condition of the existence of companies is taking part and survival of competition
- When wording the message of a company competition advantage is of utmost importance, that is: What can the company perform better than others?
- Market competition does not only concern products but it is a challenge of various levels and places.
- Successfulness of companies in competition can be expressed by competitiveness.

☞ **Competitiveness: Ability of a company to produce products and services on long-term to consumers by keeping norms of social responsibility and consumers are more willing to buy their products more than those of the competitors by paying enough to gain profit. Condition of this competitiveness is that the company be able to sense and react to changes of the environment and those within the company by completing more favourable market competition criteria on long-term than their competitors.²¹**

Factors determining competitiveness of companies can be divided to internal and external ones and can be grouped as follows:

²¹ CZAKÓ Erzsébet–CHIKÁN Attila: Our Competitiveness from Company Aspect 2004–2006. Management Studies, 2007., 38. year. 5. issue. 2–8. p.

Macro-level factors (PESTEL)22. Figure: Chart of macro-level factors ²²

Political: economy-, development-, support-, tax policy, etc.

Economic (!): tendencies in GDP, investments, inflation, unemployment, etc.

Social: demography, education, culture, way of life, habits, traditions, etc.

Technological: R&D, expenses, innovation, patent system, developmet of ICT, etc.

Environmental: eco-conscious way of thinking, ecotechnology, green movements, etc.

Legal: legislation, labour law, taxation, association law, comperirion law, etc.

A. *Microlevel factors*: besides traditional competitive advantages new types of competitive advantages gain more and more place.

classic competitive advantages: eg. less expenses, lower price, better quality, more effective marketing work, higher level joining services, etc.

new types of competitive advantages:

- capital orientation
- technical development trends
- global market structure
- trained labourforce
- patents, know-hows, softwares
- strong customer relations

²² Source: CAMPBELL, DAVID – CRAIG TOM: Organisations and the Business Environment, Butterworth-Heinemann Ltd. 2005., 501. p.

- brands
- unique organization structure models, procedures
- preparedness of company managers: recognition of changes in the environment is more and more expected from managers, etc.

A company can only get and maintain competitive advantage on long term if they are capable of recognising and forecasting real content and future changes of external and internal environmental challenges and of utilising and creating opportunities. Existence of competition makes market coordination efficient thanks to its economy organising features. This economy organising feature appears in *triple function of competition*:

- **Welfare function:** The biggest possible financial welfare should be created by making individuals as consumers possible to choose according to their own aspects (value, usefulness, purchasing power) from the products offered by competing sellers.
- **Allocation function:** It influences, even forces producers to invest their available resources into producing goods which satisfy consumer demands.
- **Efficiency function:** The fight for the money of the consumer makes producers manufacture their goods in the biggest possible efficiency. This way resources of the society are headed for producers offering very efficient future growth based on capital market mechanisms.

Competition is means of deliberate organisation of economic activities which has crucial role in satisfying needs and organising production and also in determining prices and revenues. The most important condition of the purity of competition is that players of economy mutually accept rules of competition. It is the task of the state and its institutions in modern economies to keep it and have it kept, therefore not only market, but bureaucratic coordination as well must take part in coordination of economic processes.

Company cooperations

In market economies company competition and confrontation is a natural phenomenon. However, such situation can happen in inter-company relations, when demand for cooperation is stronger than confrontation. Through cooperation companies can get to more advantageous situation than without. The concern is whether the cooperation is for the benefit of the society or not.

A. *Economy organisation activities*: These steps enhance efficiency of the economic system. In the previous unit concrete forms of manifestation were discussed (cooperation, strategic cooperation, joint company). As for the direction of the cooperation it may be:

- **horizontal**, meaning that competitors having operated previously on the same market start to cooperate in certain fields, eg. development, costdecreasing procedures, common marketing activities.
- **vertical**, when buyers and suppliers cooperate with the given company.

B. *Cooperations to restrict competition*: The other form of cooperation is when participants make agreement at the expense of other players of economy. Although in developed countries it is sanctioned by legal means, they appear from time to time, since it is fundamental interest of certain players of the market. Similarly to the previous ones these forms can be divided in two parts:

- **Horizontal agreements** are when companies restrict inter-company competition to gain advantage together against consumers. The most typical types are: price agreement, division of markets, boycott, restriction of getting products, etc.
- **Vertical agreements** are aimed at gaining advantage over suppliers, buyers, the most important types of which are eg. fixing price against suppliers, buyers, fixing middleman contract, fixing compulsory prices for middlemen, etc.

These agreements are collectively called cartell agreements.

☞ **Cartell: Coordination of the operation of several companies aiming at hindering, restricting or distorting economic competition.**

Company nets

The period right before and after the millenary caused fundamental alterations in developed economies. Spread of the development of technology thoroughly has changed company economy, processes have become more efficient, information, abilities and knowledge have become resource of utmost importance. Competition is more and more becoming innovation oriented, companies base their competitive advantage on these factors. Deconstruction (dismantling traditional structures) of big companies started in the US already in the 80-ies, and company nets based on strategic partnerships have been created. These strategic cooperations have fainted away borders between companies where tight interdependance has become dominant. In the

21st century competition between companies is more and more placed to the level of company nets. Success of company partnerships depends on the following factors:

Commitment: companies taking part in the net are interested in long-term cooperation

- *Coordination:* efficient cooperation between the companies results in efficiency of the net
- *Mutual dependance:* together they can achieve targets which alone they could not
- *Trust:* It enhances efficiency of cooperation because the members spare hierarchic control generating big expensis

Bases of more and more complex world economy are formed by such nets, and real losers of international competition are the ones misedd out of these nets. Classification of company nets can be done by various aspects, a most important type of it is the following:

- **Clusters** mean an important type of horizontal cooperation which are companies operating in a certain region and having identical or similar profile, very competitive ones and mean a joint net of other institutions. (Porter 1998)

 *eg. such one is Silicon Valley and Pannon Autóipari Klaszter (PANAC) 24 in Hungary. Their strength in competitive advantage is concentration of knowledge, connection and motivation.*

- Important parts of vertical cooperation are **so called chains of supply** consisting of companies of vertical and horizontal connection formed for satisfying a certain consumer need.

4.3 SUMMARY, QUESTIONS

4.3.1 Summary

Market is the most natural means of coordination to influence behaviour of the players of economy, the most important factor to regulate modern economy. Besides theoretical theses facts of history also prove that economy regulation based on market mechanism has been able to show up the greatest successes in societies so far. The significance of market coordination is not entirely restricted to economy, several arguments support that market based economy is the most successful concerning the whole of the society. The most important ones are:

1. **Market mechanism gives dinamism to the society** because competition inclines constant innovation, makes selection and it

gives players of economy impetus which makes two elements of basic target, that is **satisfying consumer needs and profitability** achievable only by constant adaption to changes of demands of the society.

2. **Simultaneous creation of big scale of independence and efficient coordination of social existence spheres is possible in an economy based on market mechanism.** Relative independence of certain spheres of existence (economy, politics, culture, science, etc.) is a basic sign of a modern society. At the same time successfulness of economy is important to create financial base of the rest of the spheres of existence. Mediator medium of market mechanisms, money, can create connection between the certain spheres without intervening into their special internal processes, leaving independence of the spheres intact.
3. **Market coordination is able to provide other spheres of the society with consistent regulation theories.** From among basic theories of market mechanism possibility of decision freedom, fair competition, connections based on equality of the partners can also be applied in other spheres of existence. While market, because of fulfilling the above functions, is recognised as a very important and useful coordination mechanism of the society, it is also wellknown, that market is not perfect either, so it could not regulate economy alone.
4. **It is not able to handle issues of equity, justness occurring in a society** (majority of them external) **and needs of the society** (eg. security issues), **public good, etc, which cannot be or very difficult to measure by money.**

As a result of it the stabile coordination systems are combined in every modern society and though in the majority of the cases market is more dominant, state sphere also plays indispensable role.

4.3.2 Self-check questions

- Specify and describe types of coordination mechanism!
- Describe main types of inter-company connections!
- Describe concept of market and categorisation ways of its institutional system!
- Characterize markets by their geographic dimensions!
- Describe possible barriers of entering a market!
- Describe possible barriers of leaving a market!
- What factors may play role in formation of competitive regulations?
- Describe concept of competitiveness and macro-level factors determining it!

Describe micro-level classic- and new type factors determining competitive advantage!

Characterize basic conditions of successful cooperation in company sets and list types of company nets!

4.3.3 Practice tests

1 In case of joint company leadership rights are also subject of the agreement TRUE

2 Markets where demand regularly exceeds supply is called buyer (Push) markets.

3 The following factors are types of classic competitive advantages: eg. smaller expenses, lower price, better quality TRUE

4 Vertical cooperation between companies mean that competitors having worked previously on the same market cooperate in certain fields eg. development, cost decreasing procedures, common marketing activities, etc. FALSE

5 Beneficiaries of strong market competition are consumers. TRUE

6 In case of horizontal agreements companies restrict inter-company competition to gain advantage together against consumers. The most typical types are: price agreement, division of markets, boycott, restriction of getting products. TRUE

7 Supply chains are companies of vertical and linear connection organised to satisfy a certain need of consumers. TRUE

5. ELEMENTS OF MACRO-ENVIRONMENT OF A COMPANY. SOCIAL RESPONSIBILITY OF COMPANIES.

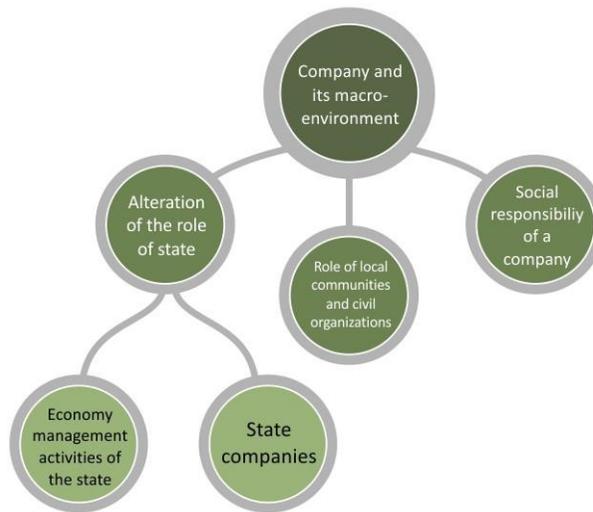
5.1 OBJECTIVES AND COMPETENCIES

The different theories of Economics are of different opinion about required extent of the presence of state in the economy but they agree that its presence is necessary. The central topic of this chapter is areas of the roles of state and its major activities related to companies. Issues of social responsibility of companies have come into view in the past decades, so from among those concerned externally role of local communities, voluntary civil organizations and natural environment have gained greater importance. The main objective of this chapter is to examine, analyze relationship, connections of these factors with companies.

In order to achieve these targets students are expected to be aware of transformation processes of economic role of the state, should know its reasons and characteristic features. They should be able to give examples on social, economic environmental phenomena which strengthen or weaken extent of the role of state. They should word basic objectives of the economic management activity of state, should know concept of economic mechanism and its economic policy means. Students must be able to distinguish company regulating roles of state. They should know possible circumstances of emergence of state companies, must know basic characteristics of mutual relationship local administration and civil sphere to companies. They are expected to know concept, main features of CSR, must be able to distinguish elements of inner and outer dimensions of CSR.

5.2 CURRICULUM

In the first part of the unit spread of the role of state in economic sphere will be discussed. Mentioned will be those factors which strengthen or weaken nature of this intervention these days. Economic management activities of state, elements of economic mechanism and means of economic policy will also be explained. Fields of the intervention of state in corporate sector will be listed. Role and characteristic features of state companies in economy, characteristics of the relationship of the institutions of local administration and civil sphere to companies will be discussed. Concept, principals of CSR from company point of view will be reviewed with its inner and outer dimensions.



8. Figure: Elements of company and its macro-environment

5.2.1 Alteration of the role of state

Founder of modern Economics Adam Smith developed his thesis at the end of 18th century about economic role of state. In his views natural operation of market always results in stability and economic growth, therefore state must not interfere in economy. In his work „Wealth of Nations”²³ Smith determined functions of state power as follows:

- Insuring external protection of the country,
- protection of internal peace and order,
- operating public institutions which for individuals are not worth running.

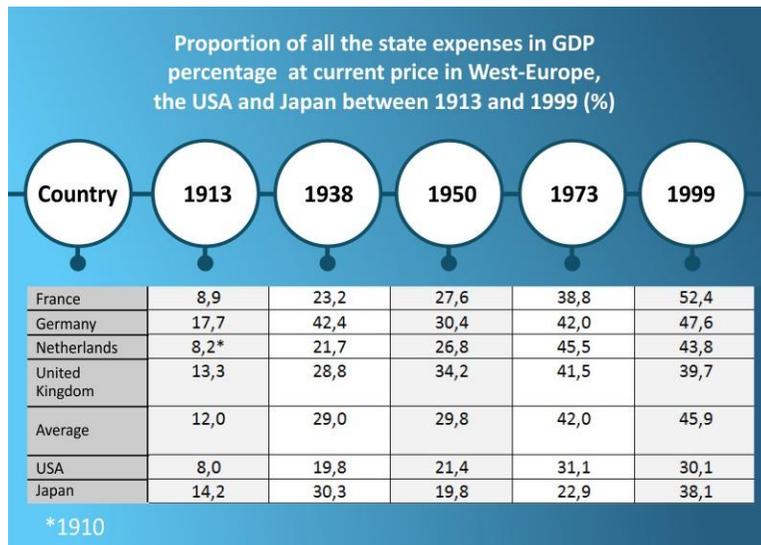
This traditional aspect is still important for modern states. A process changing this approach started at the end of 19th century and resulted in the growth of economic role of the state. The main aim of state intervention originally was to ease social tensions by decreasing poverty. Later the state took major part in developing infrastructure, which, indirectly, also served achievement of the previous aim. Intensified demands of left wing movements of the era also played important role in altering the economy. In Germany social acts of Bismark were issued, while in Britain the results are similar with the growing power of trade unions.

²³ SMITH, ADAM: Wealth of Nations, Akadémiai Kiadó, Budapest 1959

Following the 1929-33 crisis demand increased to enlarge economic role of the state. By the theory of a British economist, J. M. Keynes the state may play important role in fairer distribution of revenue, indirectly in increasing insufficient macro-demand by redistribution. Development of state investments, public services and infrastructure may result in increase in production and consumption. After World War II wish for reconstruction further increased need for the intervention of the state in Europe. Lasting economic development created the possibility for building institutional welfare allowances through active role of the state. Besides these scientists also examined issues of economic efficiency specially focusing on the following:

- public goods,
- market distorting effects of monopolies, oligopolies,
- external economic influences,
- information dissymetry in economy, etc.

Thanks to favourable conjuncture conditions, increasing revenues and increasing rate of state expenditure expansion of tax revenue could generously finance state investments, social expenses. In the altering function greater priority has been given to developing healthcare, education, infrastructure. Extent of redistribution from general around 12% at the beginning of the 20th century rose to more than 40% by the 1970-ies in the developed countries.



9. Figure: Proportion of all the state expenses in GDP percentage at current price in West-Europe, the USA and Japan between 1913 and 1999 (%)²⁴

In the last third of the 20th century there was a halt in the development of welfare states. To ease serious social tensions in 1968 considerable wage increases were implemented in West Europe which surged inflation. Between 1973 and 1980 oil prices increased tenfold strengthening feature of stagflation.

Fiskal economic policy of Keynes did not bring solution in this situation, what is more it further generated inflation. Thus those aspects came in foreground which said the state should decrease its participation in the economy, this way alter its institutional system and strengthen privatization and deregulation processes. On figure 5. it can be seen that in some countries rate of governmental contribution really decreased in relation to GDP between 1973 and 1999.

In the 1990-ies doctrine of Washington consensus meant the most important directive in economic policy, which considered currency devaluation, monetary restriction, balance of budget of primary importance in macroeconomy, while in microeconomy it was liberalization

²⁴ Source: MADDISSON, ANGUS: The World Economy: A Millenial Perspective, OECD Development Centre, 2001. 65. p. http://www.oecd-ilibrary.org/economics/the-world-economy_9789264189980-en 1913-1973 and OECD Economic Outlook 1999. December Table 28. <http://webdoc.sub.gwdg.de/edoc/Im/ingenta/sourceoecd/66.pdf>

of finance and commerce and also privatization and deregulation. Liberalization of economic processes made influence on purchase and sale of allocated loans, rate of currency exchange, deals made on bond and share price changes, that is derivative deals. Banks stopped collateral of compulsory capital reserve related to their allocations, commercial and investment type banking services completely merged. Speculative, free international hazard deals with hedge funds surged so much, which created undefendable risks without regulation.

These factors largely contributed to the onset of the crisis in 2008, which increased those recommendations that the state should again take higher role in economy. However, the old recipes cannot be used nowadays any more. The institutional system constructed to the social-economic challenges of the 20th century will not be adequate to the challenges of the present and future. New technologies, globalization of capital flow and commerce has been causing large-scale workforce-market confusions, aging population means new challenges. Nowadays improvement of healthcare, education, R&D, infrastructure are all areas which will be determining features of the fate, competitiveness of countries. The response to these challenges would be a restructured, more effective state function, attempts to which can already be seen

Economic function of the state nowadays

It can be seen from the above mentioned chapter that certain directions of Economics assess economic responsibility of state in different ways, but they agree without debate that it is necessary in the present and future, too. Worldbank (1997) mentions the following responsibilities of modern state in economy:

- determining legal frames,
- shaping economic policy,
- providing fundamental services and infrastructure,
- protection of handicapped,
- protection of the environment.

Nowaday contradictory tendencies occur, there are both economic, social processes that strengthen and ones that weaken its role.

Tendencies that modify rate of responsibility of state

Majority of these effects are related to globalization and the development of science and technology.

Factors which strengthen responsibility of state:

- The different countries are not affected by globalization identically, so how successfully can a nation-state join this process greatly depends on the institutional system of the state and its efficiency. Coordination of the global world is often done by institutions, the operation of which is not independent of nation-states.
- In developed countries it is a tendency that role of the state has been increasing in making connection between certain social spheres (healthcare, education, culture, etc.)
- Appreciation of the role of human resources enhances the necessity of state regulation in several fields, eg. conditions of employment, healthcare, pension, education, etc.
- Developments, investments in infrastructure (road system, communication nets, etc.) cannot still miss out on the state.
- Wide layers of the society concerned justifiably or not about globalization and phenomena of consumer society expect stronger protection from the state.

Factors which weaken responsibility of state:

- In several developed countries in the past 30-40 years, due to reasons mentioned in chapter 1. operating services (railway, motorway, electricity- and gas supply, communal waste management, etc.) previously done by the state have been placed over to market basis and have been prosperous from society aspect as well.
- Due to globalization phenomena supranational institutions have been created in various fields which coordinate the given issue not at national level, but in world dimension, so these authorities gradually are out of the scope of nation-states. (eg. WTO – World Trade Organization, WHO – World Health Organization, ILO – International Labour Organization, ISO - International Organization for Standardization, etc.)
- Several phenomena are becoming global which go beyond borders of nation-states, therefore they demand regulation above nation-states. (eg. harmonization of environment protection, flow of information, etc.)
- Due to regional and monetary integration part of state regulated tasks of the members previously practised in national powers is

taken over by the integration regulating body. (eg. decrees of the European Committee, decisions of the European Parliament, etc.)

- Development of technology, spread of IT tools make state-level regulation impractical, sometimes even impossible in several areas. (eg. internet-based possibilities in taxation, gambling, etc.)

Basically two streamlines can be seen in the alteration of state responsibilities. On the one hand civil sphere actively takes part in certain parts of traditionally state regulated economic, social processes and corporate sector also takes more responsibility in solving issues of non-economic character. Practically it means that in processes traditionally considered as state tasks besides bureaucratic coordination ethic and market coordination is becoming stronger as well. On the other hand as a result of globalization economic integration of certain regions and multinationalisation of business life is much faster than political-social integration, that is state administrations are more different than business systems.

5.2.2 Economy coordinating activity of state

The aim of the economic responsibility of the state basically is to create conditions of joining global competition successfully 95nt he way that it lead to economic development and maintenance of social welfare. To achieve 95nt he following tasks must be accomplished:

- To transfer global effects, by influencing it as far as possible: 95nt he one hand countries should be able to gain advantages from globalization, 95nt he other hand they should be able to produce resources necessary for structural conformity.
- Connection between certain coordination mechanisms must be strengthened: elements of the relationship of political sphere to economic system must be created (economic mechanisms), and also activities necessary to fulfil them within economic policy.
- To achieve social targets such means (tools) of regulation must be created with the help of which influence of the state on economic sphere can be realised (means of state regulation)

Means system of economic mechanism and state economic policy

- ☞ **Economic mechanism: It is the legal and institutional frame of the connection between the economic players including rules of the operation of economy, also social, political, moral, ethic norms.**

Features:

- These decisions are usually made for long term, sudden changes in them can only be caused by major social-economic disasters (eg. change of economic systems in Hungary in 1989, or economic world crisis in 2008).
- Market coordination and bureaucratic coordination mentioned in connection with coordination mechanism need completely new economic mechanism.
- Since nowadays developed countries are mixed economies and proportion of bureaucratic coordination may be different in different countries, therefore their economic mechanism is also different.

 **Economic policy is activity of the state to alter its economic-, legal-, institutional system and to directly influence economic processes.**

Features:

- General objective of economic policies is to insure economic growth while maintaining economic stability.
- Nowadays supporting competitiveness of the country has become an important aim of economic policy so that the companies can do well in global competition. Therefore such macroenvironment must be created which does not at least put them in disadvantage.
- Revenue regulation has also become an important priority of economic policy, the aim of which is that theory of fairness, performance and solidarity is fulfilled in the best possible way between the players of private sphere (households, companies).

Responsibility of state from company aspect

Economic role of state concerning its context with companies may be of three types:

- Restricting factors, violation of which will cause sanctions.
- Influencing factors which companies should pay attention to, because with their help the company can operate more successfully in its economic environment.
- Facilitating factors which make it possible for the company to gain advantages against their less successful competitors in the private sphere (eg. lobbying).

 **Lobby activity: All kinds of activity or behaviour aiming to influence decisions of public power or advocacy done per procurement, in businesslike way.**

Lobbying is an important gear of economic responsibilities of the state. Cause of intervention into economic processes often is that various players of economy (eg. companies, company groups, consumer-, regional or minority advocacy groups), using different methods within the frames of legislation and ethics, persuade representatives of state institution system about the necessity of intervention or its positive outcome.

Company regulating role of the state is of three spheres:

Scope of company regulation: These means affect the activity of the company directly, the elements of which are:

- *state taxes and transfers* (eg. product tax, advertising tax, corporate income tax and family allowance, unemployment benefit, income support, etc.)
- *compulsory requirements:* concerning sales of products and services, conditions of employment, minimal wages, establishment of company, company forms, performing activities, etc.

A. **Scope of regulation of inter-company relations** (concerning regulation of relations with certain externally involved ones):

- *Competition regulation*, aiming at improving economic performance by restricting behaviours and market structures judged to be harmful from public aspect. Its elements are:
 - prohibition of unfair competition
 - prohibition of misleading consumers
 - prohibition of statements restricting economic competition
 - prohibition of misusing economic dominance
 - fusion control (the previous regulates four behaviours, the latter one market structure)
 - regulation of connections of local administration and companies
- requirements on environment protection

B. **Regulation of intra-company relations** (concerning regulations relating internally involved ones):

- *Regulations concerning the owners:* regulations on ownerships (estrangement, heritage, interests conflict, etc.) and rules concerning company mergers.

- *Regulations concerning managers:* mostly regulations on employment.
- *Regulations concerning employees:* These regulations are also mostly connected to employment.
- Besides previously mentioned state as externally concerned 98nt he company can perform various furthe functions:
- *Development supporting role:*
- Modern state can support innovation, development within its general economy developing activity by providing the company with
 - direct support and
 - creating favourable, stimulating ennvironment.
- *-Partner role:* The state can appear in private enterprises as:
 - *co-partner, or*
 - *can involve private enterprises in performing public tasks (PPP construction /Public –Private Partnership).*
- *Consumer role:* Public orders may be significant both in volume and spectrum, so they mean consumer market for numerous private enterprises, eg, road constructions.
- *Competitor role:* Certain state companies as market players 98nt he well take part in satisfying market demand, just like private enterprises, eg. Paks Nuclearpower Plc.

Environment of company economy is created by joint effects of international economic tendencies and economic policy of the given state, which companies must adapt to. Success of adaptation is basicly influenced by two factors: 98nt he one hand permanent or transitional character of certain long-term tendencies must be recognised, 98nt he other hand short-term volatility must be reacted 98nt he fastest possible way. Relationsip of state and state institutional system is naturally not one-sided. Success of operation of a state institutional system thoroughly depends 98nt he efficiency of the business sector which is of primary importance in providing resources for the government to achieve its economic and social objectives.

State companies

The state can practise its influencing role to achieve various of its social and economic objectives by establishing state companies. These objectives may be of various character, but the most frequent ones are the following:

- Supporting governmental aspirations: eg. achieving employment political targets in a handicapped region or industry.
- Producing certain public goods: eg. to provide favourable price or to handle externals.
- Setting example for companies in the private sector: by higher wages, better working conditions, etc.
- Terminating monopol situation in certain industries by creating a competitor.

A state company may be different from the ones operating in the private sector in several major characteristics:

- Its ownership rights are usually practised by its various institutions.
- The basic target is not exclusively profit requirements.
- In its business policy, pricing not necessarily do market aspects appear, but beyond-economy factors as well.
- In the company management presence of employees is often more dominant than in that of private sector.
- Economy, finances of state companies are more open, transparent to the public, their operation is done before the media.

- Several researches support that state companies usually operate with lower efficiency and profitability than private ones, so based on it many question their worth. However, it also must be taken into consideration that these companies often operate in situation, environment which provide unfavourable conditions for profitable operation. During the privatization procedures of the past two decades it has often turned out that several activities can be run cheaply and efficiently by involving the business sector, this way supporting the aspect that creating a state company is a drastic method for state influence. However, hardly can it be debated that these companies also have *raison d'être* in modern societies, but in which areas, it is decided by the peculiarities of the country.

5.2.3 Local communities and voluntary civil organizations

In modern societies bigger and bigger part are taken part by organizations totally or partly independent from the state, named as civil organizations of citizens. These organizations permeate spheres of the society representing multiculturalness, complexity of different social interests. Besides organizations of local government here can be mentioned chambers organised on different professional basis, various sport-, freetime-, cultural associations, green organizations. Companies

have different levels of connection with these social groups directly or indirectly influence their activity, eg. by subsidies. Companies also get a lot of different impulses from them, nowadays a company cannot afford not to pay attention to these organizations. Through this interrelationship these organizations also belong to the circle of those involved.

Role of local communities

A local society very often may have a group of problems the effects of which only appear at local level or their origin also comes from local factors. In several cases it is more advisable to trust local players to solve these problems rather than central organizations. On this basis is created and developed the set of connections of local companies and communities. If big autonomy is given to local governments by the state, they may become engines of national development seen by the Swiss or American example. Local communities and local governments representing them perform a triple function. They have to create and insure:

- A. **economic security:** security of workplaces and businesses, possibility for meaningful, successful and healthy work to satisfy basic needs,
- B. **local democracy:** those concerned take more and more comprehensive part in making decisions affecting their life, possibility of democratic control in local government,
- C. preservation of cultural heritage and natural environment.

Local administration plays dual role in its connection with company sector partly that it functions as part of central administration and also as representative of local community. This duality often cannot be separated in practice. One dimension of the relations of the parties mentioned is manifested in bilateral financial transactions. During it often happens that a company contributes to the development of local community in a way by concrete financial transfer. Institutional way of it is local taxes, but besides them voluntarily provided subsidy can also be of considerable size, this way improving conditions of local environment, being the direct geographical environment of the company also the living space of its own employees, it also contributes to increasing welfare of its own employees. However, the relationship is not of one-sided, local administration also has a lot of tools to advance companies and encourage them to local developments. A concrete example for it is local tax reduction given to companies, property purchase possibilities below market price, participation in workforce development, etc. Fortunately it has been being recognised during the past decades that issues of

regional inequalities, unemployment, poverty, etc. can only be solved really effectively by involving several ones concerned. Besides state responsibility also local communities, companies must take substantial part in handling these problems.

In order to create mutually fair and advantageous relationship companies and local administration must cooperate in harmonising their strategic plans. Success of company development is greatly contributed to if they are in harmony with the wish of local inhabitants and plans of administration. It is also important to take „soft” factors of development into consideration: sustainability, even improvement of human and natural environment is in basic interest of every actor. However, it also must be mentioned, that too tight connection of the two spheres mentioned may bear harmful results for the society, like local corruption, negligence over environmental damages, etc.

Connections of voluntary civil organizations with companies

These organizations play increasing role in modern societies. One of their functions is manifested in taking over certain social functions from the state and citizens. For example civil originated initiatives of family care, or voluntary legal organizations working to enforce citizens' rights are good examples for them. Other institutions follow activity of the market and intervention of the state. In developed countries such consumer- and environment protection groups work which have gained substantial influence in market sphere. Here can be mentioned professional organizations, like chambers, employers'- and employees' associations, branch- and functional specialized unions which have important role in flowinf information, edication, training, advocacy. These organizations may do their activity in different contexts:

- They play mediator role between the state and companies,
- they may deepen connections between companies of the branch..

Role of voluntary civil organizations is becoming increasingly important with civil society strengthening and appreciation of non-economic values, so these values, completed with the spread of human-centered management phylosophies, encourage widening of not directly profit oriented activities.

5.2.4 Social responsibility of companies

By social responsibility of companies such business behaviour is meant through which the company gives advantages to stakeholders with which their welfare, long term value is positively influenced. (Naturally environmental issues must also be considered here.) Companies

manifesting the ideas of CSR, Corporate Social Responsibility wish to increase their goodwill, improve their social image and their profitability so this way their competitiveness through social responsibility that in the meantime they meet ethical and environmental requirements expected of them. Definition of CSR of the European Commission is the following: Corporate social responsibility is „a procedure to integrate social, environmental concerns into their business operations in close collaboration with their stakeholders".²⁵

Emergence and development of CSR

In spite of the fact that companies have been existing and doing economic activity for hundreds of years social ethic and economic ethic responsibility was not separated for a long time. Emergence of modern companies started fundamental changes in this issue from the middle of the 18th century. Giant company empires emerged by the beginning of the 20th century make the whole of the economy felt also their negative effects as a response to which civil organizations emerge which criticise not always ethic operations of these firms. Those big company managers who also realize responsibility attached to their position perform activity approving basically welfare of their employees and direct environment. It usually means workplace security and measures to improve welfare of the local community.

In the 1960-ies studies are issued to call the attention on serious social, environmental problems resulted from the growth of large companies and their conclusion is that these issues must be handled through company targets. By the 1970-ies three main directions of corporate responsibility appeared:

- on the one hand it emphasizes that operations of companies must correspond to legal requirements, first and foremost related to employees and production,
- on the other hand it emphasizes ethical responsibility of companies to environment protection and employment,
- thirdly it emphasizes importance of improvement of complex social-natural environment.

Companies first started to deal with identification of demands of stakeholder groups and handling specific problems when stakeholder-theory appeared in the 1980-ies. Realisation and public awareness of

²⁵ European Commission: Promoting a European framework for corporate social responsibility – Green Paper, Office for Official Publications of the European Communities 2001.

global environmental problems also occurred at that time. Strategic approach to CSR emerged in the 1990-ies, through which companies realized that this approach may be matched with competitiveness and therefore with company interests on long-term. In the 21st century an increasing part of large companies not only consider the attitude useful and good but they also hope for returns on long terms. More and more of them recognise that success of the company and community mutually enforce each other. Although environment centered management systems appeared at the end of the last millennium, they became widespread just at the beginning of the 21st century. ISO 26000 standard was issued in 2006 the aim of which was to help organizations in their contribution to sustainable environment and in realizing responsible behaviour to society and environment. When implementing these processes the company can improve quality of its relationship to its customers, government, business partners and the community they operate in. Improvement of goodwill may have different results: it improves life quality of employees, it helps to attract and keep workforce, investors are more willing to invest in a less risky, ethically working organization.

Dimensions of CSR:

The European Commission summarised the principals and dimensions of a responsible company in Green Papers published in 2001 as follows:

A. Dimension within the company:

- The most important topics related to human resource management are discussed, like insuring equal chances, possibility for life-long learning, right proportions of work-family- relaxation, etc.
- In workplace health- and security fields actions on voluntary basis aiming at improving security at workplaces are the most important ones.
- It connects tasks of crisis management with CSR, since characteristic nowadays rearrangements, redundancies may have spiralling effects on various layers of the society.
- In its operation it must tend to reduce energy-and raw material consumption and to pay attention to waste management when managing environmental challenges.

B. Dimensions outside the company:

- When improving good relationship with local communities the company can achieve mutual advantages through its employment policy, financing education, charities, supporting local culture and sport.

- In connection with business partners, suppliers and customers it is important that not only are exclusively business aspects dominant, but through CSR approach they can strengthen mutual trust as well.
- Human rights issues also include combat corruption and other ethic behaviours.
- Global environment protection aspects embody ideas of sustainable development, that is satisfaction of the needs of present generation must be insured in the way that it does not decrease chances of future societies.

5.3 SUMMARY, QUESTIONS

5.3.1 Summary

Coordination tools different from market mechanism are equally important in economy and society as well. Economic responsibility of the state dated back to bygone times, even nowadays it has important economy influencing function. In modern economies state influences operation of companies partly by economic political means directly influencing its operation and indirectly, by regulating its internal and external connection system. State companies may operate in several economic spheres, their proportion, characteristics mostly depend on the economic, social conditions of the given country. In the past decades organizations of local administration and voluntary organizations, groups of citizens have been playing increasingly dominant role. These communities are getting closer to business sector, principals of their correlation are given by the concept of social responsibility of companies.

5.3.2 Selfcheck questions

Determine traditional economic roles of the state and those fulfilled nowadays!

Distinguish strengthening and weakening factors of economic responsibilities of the state!

What do we mean by economic management activity of the state and what are the tasks it has to accomplish to achieve it!

Distinguish economic mechanism from economic policy!

Enumerate fields of company-regulation role of the state!

Reveal causes of the emergence of state companies, and distinguish characteristics of state company from the ones of private sector companies!

Characterise the connection system of local communities and companies!

Characterise the connection system of voluntary civil organizations and companies!

Describe the concept of CSR and circumstances of its emergence!

Describe the dimensions of CSR!

5.3.3. Practice tests

- 1 In the 1990-ies doctrine of Washington consensusu strengthened degree of state intervention into economic processes FALSE
- 2 A principle of social reponsibility of the state is to creat conditions to be able to join global competition in the way that it leads to the development of economy and maintenance of social welfare. TRUE
- 3 General aim of economic policies is to insure economic growth in the way that at the same time economic stability is also maintained. TRUE
- 4 The state may appear as copartner, it is named PPP conception FALSE
- 5 Basic aim of a state company is profitability FALSE
- 6 There are always contradictions betwwen companies and local governments FALSE
- 7 Influence of consumer- and environment protection groups in market sphere is slight. FALSE

6. INNOVATION ACTIVITY OF THE STATE

6.1 OBJECTIVES AND COMPETENCIES

Silicon Valley can be found in US, California. The region got its name from silicon-based chips developed and produced locally. Beginning from the 1970-ies the place has become one of the most important centres of IT industry of the world, venue of the invention of various informatics instruments (integrated circuit, microprocessor, PC, etc.) and location of the birth of different high technologies. Nowadays it is home of numerous world companies (Apple, HP, Google, Cisco, AMD, Intel, etc.), so Silicon Valley - rightly – has become synonym of innovation activities.²⁶ Innovation, as one of the most important methods of acquiring competitive advantage has become a major precondition for successful work of companies. Strategic importance of this company activity both at SMEs – small and medium enterprises and in large company sector is unquestionable. In the following unit our aim is examination, evaluation of innovation activity of companies.

E cél sikeres elérése érdekében, a hallgató ismerje meg az innováció tartalmát, jellemző vonásait. Legyen képes csoportosítani az innovációk típusait különböző szempontok szerint. Ismerje a vállalati innovációs stratégia szerepét, az azt befolyásoló környezet jellemzőit, a stratégia elemeit, valamint a sikeres megvalósításának főbb kritériumait. Legyen tisztában az innovációs tevékenységek fő folyamataival, illetve ezek egymáshoz való viszonyával, tudja jellemezni az egyes innovációs modellek főbb jellemzőit.

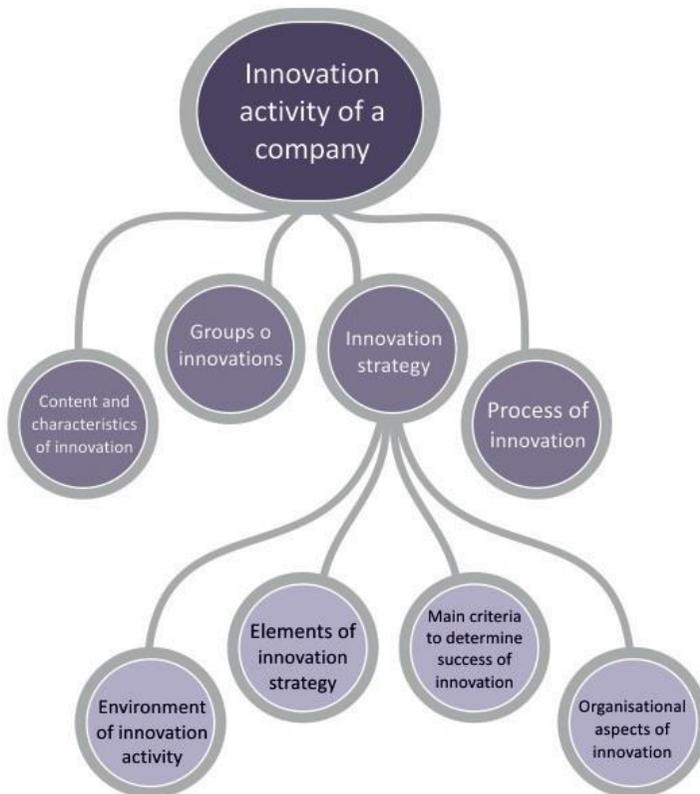
To achieve this target students must know content, characteristic features of innovation. They should be able to classify types of innovation by different aspects. They are expected to know role of innovation strategy of a company, features of the environment influencing it, elements of strategy and main criterias of its successful implementation. They must be aware of the main processes of innovation activities, their correlation, should be able to analyse main features of innovation models.

6.2 CURRICULUM

In the first part of the unit basic characteristics of innovation will be focused on, then it various types will be grouped according to their most important features. Further will be analysed emergence and circumstances of innovation strategy of companies. First we will examine

²⁶ www.siliconvalleyhistorical.org/

influence of external stakeholders on the formation of innovation strategy, then its concrete elements will be discussed. We will enumerate those factors which greatly may influence success of innovation, specially focusing on cardinal role of company management. In the last part of the unit development of innovation models of the past 60-70 years will be surveyed. (The main reason of it is that basics of innovation theory were first published in the study of Joseph Stumpeter in 1934.)²⁷



10. Figure: Characteristics of the innovation activity of a company

6.2.1 Content and features of innovation

Indispensable condition of the survival and successful operation of a business in a dynamic market environment is to be able to realize profit

²⁷ SCHUMPETER, JOSEPH A.: *The Theory of Economic Development: An Inquiry into Profits, Capital, Credit, Interest and the Business Cycle*. Oxford University Press, 1934., London.

on long term. After creating their message companies must determine their scope of activity. This way the company must ask the following questions:

- What kind of consumers, their what solvent needs
- how and what way do they want to satisfy?

To answer the first group of questions the company must determine how it want to be present on the market. Therefore they must choose the target market they want to offer their products to and by various (marketing) tools they must achieve that people buy from them. The creation and implementation of these activities is done by the marketing function of the business. This function expresses market orientation of the company.

In connection with the second group of questions the enterprise must perform its activity in the way that they realize it more effectively, than the competitors, adapting better to the needs of consumer demand. Creation and implementation of these activities are dony by the innovation function of the business. This function expresses consumer orientation of the venture.

Three major types of innovation can focused on:

1. Consumer orientation
2. novelty
3. uncertainty.

Content of consumer orientation

Consumer needs can basicly divided in two parts, expressed and latent needs. The previous ones include demand which is in the mind of the consumer, he can concretely name it. The expressed needs are very well known by the competitors of the company, their resources are spent to atisfy these demands. Latent needs are demands existing at every consumer, which do not get to his mind. To be better than competitors, the company must explore latent needs of consumers and find solutions for satisfy them. It must be of dynamic process because if a company has revealed a latent demand (which, this way turns into expressed need)and satisfies it properly, competitors will sooner or later will copy it, so competitive agvantage of the company melts away.

To achieve competitive advantage it is not always necessary to develop a new product. The essence of innovation is novelty which was mentioned in Economics as long as seventy years ago. Concept of innovation was introduced by Joseph A. Schumpeter (1939), who

emphasized new combination of production factors as essence of innovation, distinguishing five baselines:

1. Production of new products unknown by customers so far (or new quality production of certain goods).
2. Introduction of new procedure, so far unknown in the industry, but it by no means has to be based on new scientific invention (it may be a new commercial procedure connected to the product).
3. New allocation possibility, that is opening a new market where the industry of the country has not been introduced yet (having though the market itself existed before or not).
4. Opening new sources to purchase raw material or semi-finished products (having though this source of purchase been existed before or it was not considered or was not taken suitable or had to be created now).
5. Creation or liquidation of a new organization.²⁸

Uncertainty

To implement innovation the company must invest money the returns of which is uncertain. It may cause problem if consumers do not take the innovation useful or competitors copy it too quickly. Innovation advantage can considerably depend on its sustainability as well.

6.2.2 Classification of innovation by various aspects

Innovation can be classified in various ways both from the aspect of companies and consumers.

Innovation can be divided in four main groups by its **concretisation**:

- A. New product or service** emerged as a new solution to satisfy a consumer need.
- B. New technology** which can be related to production of a new or already known product or service.
- C. Market innovation** meaning new purchase or/and sales possibility for the company.
- D. New structure solution** in case of which both the product and the technology can be new or even old, but fit in the organization in a different from the previous way.²⁹

Possible sources of innovation may be as follows:

²⁸ CHIKÁN Attila: Business Economics, AULA Kiadó, 2008. 245. p.

²⁹ CHIKÁN Attila: Business Economics, AULA Kiadó, 2008. 246. p.

- Unexpected success, failure, external event,
- contradiction between reality and plans
- needs of the process,
- changes in the structure of industry or market,
- demographic changes on population,
- changes in attitude, atmosphere, sense
- emergence of new knowledge (scientific and non-scientific).

Drucker, based on the above ones sees possibility and necessity of company innovation when a kind of discrepancy occurs in processes.³⁰

Innovation also may be classified by the extent of difference:

- **Radical innovation** means essential, dominant innovation, that is radical change: eg. new product, new product function, new machine in the production, etc.
- **Incremental innovation** means development in small steps when only small elements of eg. products, technologies are modified, eg. product is made waterproof. In car industry „face lift” of certain car types are typically such kind of innovations.

Finally innovations can be classified by their motivation:

- **Technology Push innovation** means companies produce the new product by planned, systematic work, that is how they launch new technology and/or structural solutions. Eg. electric appliances of entertainment industry, smart phones, smart tv-s are good examples of this type.
- **Demand Pull innovation** means that development is generated by a concrete market demand. Development of medicines, food supplements are typically innovations of this category.

The definitions to be found and acknowledged in literature are in line at several points being though of very different approach. Based on these similarities the most characteristic elements of innovation are as follows:

- Innovation always means creation of something new.
- Innovation always means application of knowledge (in a product, service, production, market activity, management, organization, education of labour force, etc.)
- Innovation activity covers all the elements of the chain of values at a company, from R&D to market launch.

³⁰ NÉMETHNÉ PÁL Katalin: Measurement of innovation activity at Hungarian companies. PhD. dissertation, BCE, Budapest, 2010., 21. o.

- Innovation is a strategic tool of improving competitiveness.
- Success of innovation is proven on the market, in practice el.³¹

6.2.3 Innovation strategy

Perhaps innovation strategy is the strongest of all kinds of functional substrategies and enterprise-wide strategy, because this function includes, expresses future orientation of the company the best. Changes of consumer needs and also message and strategy of the company are dominant in creating innovation strategy, in which innovation activity must be given suitable environmental conditions.

Environment of innovation activity

Creation and implementation of innovation strategy is thoroughly influenced by economic and environmental climate, significantly determined or influenced by external stakeholders of the venture.

- Cooperation with **consumers** is essential in order to generate innovative ideas. The company must do proactive initiatives in this field.
- Willingness for tighter cooperation with **suppliers** may result in similar innovation ideas.
- **Competitors** have fundamental influence on innovation strategy and also the concrete activity of the company on both short- and long term.
- In developed countries **state** supports innovation processes by various intense means. They may be direct subsidies or economic policies of the state creating favourable, innovation enhancing environment.
- Cooperation of enterprises creating **strategic alliances** is not restricted to purchase, production and sales processes, but increasingly it starts with common innovation activity.
- **Local voluntary or civil communities** – especially in developed countries – more and more determinedly force enterprises to perform and promote new innovative activities in order to protect **natural environment** or other concerned.

³¹ HUSTI István: Elements of innovation management University study-book, Szent István University, Gödöllő, 2010.

Elements of innovation strategy

Planning and implementation of successful innovation strategy basically depends on four issues:

1. What attitude does the company have to novelties? (What are the conditions of the emergence of innovation?)
2. In what extent is the venture pioneer or follower in the field of innovations?
3. What is the target of innovation strategy?
4. What conditions may influence market acceptance of the innovation?

1. Two basic types of innovation processes can be distinguished:

- **Radical innovation strategy** means the company produces the novelty as a result of determined, conscious development work, by implementing company projects. At the beginning of the activity a well-defined target is set implementation of which can continuously be controlled. Major criterias of its application are:
 - Continuous observation of trends in the competition environment,
 - long-term thinking attitude,
 - consistent system of aims and actions of organizational units
- **Incrementalist innovation strategy** means that the main aspect is to create company conditions to enhance innovation. The firm encourages tendencies for innovation, but usually no concrete targets are set. Development is achieved by small steps, activities are more or less spontaneous. The main processes of its application:
 - Little steps towards not very concrete targets,
 - measuring effects of the steps,
 - adjusting targets (if necessary),
 - decision about the next step.

- ☐ Financially strong large companies usually prefer the first, while sometimes more dynamic small enterprises prefer the second type. Both types are usually of the same effectiveness.

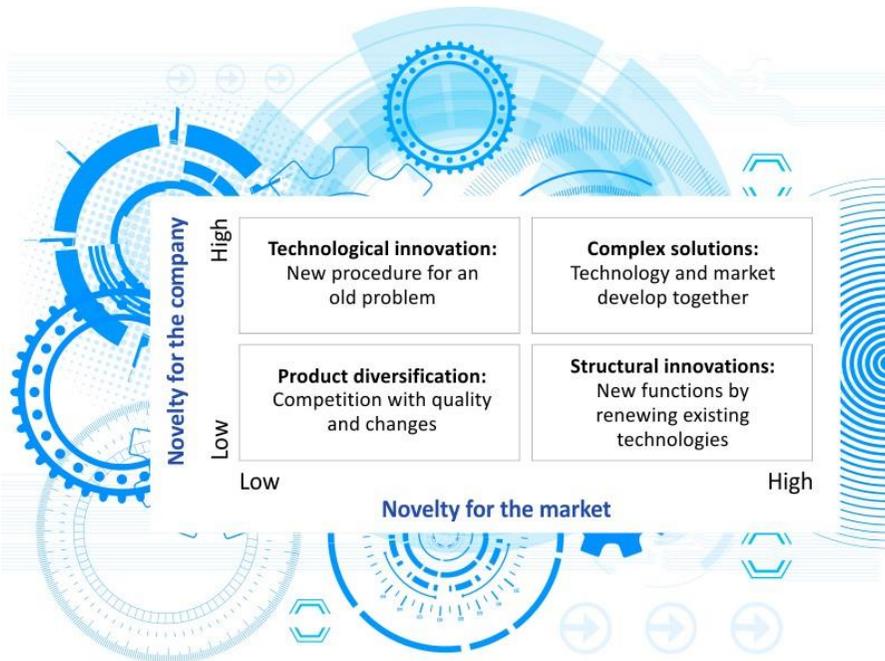
2. Types of innovation strategies according to how much the company is a pioneer in introducing and applying a certain innovation

- A. **Proactive innovation strategy** means the company tends to be a pioneer in innovation, does intensive research and development activity (basic research as well), and besides undertakes risky, radical innovations as well. It considers protection of business secret and intellectual product important.
 - B. **Active innovation strategy** means that company is not the first to innovate, but tends to catch up quickly, in its research and development activity it mostly focuses on applied sciences, targets medium risk, mostly incremental novelties.
 - C. **Reactive innovation strategy** means that company waits, takes over novelties late, initiates exclusively low-risk, incremental innovations, the knowledge, necessary to it is taken over from outside.
 - D. **Passive innovation strategy** means that company has no formal innovation activity, incremental innovations are sometimes introduced by customer pressure, does not usually take risks.³²
- ☐ Pure manifestation of these types are quite rare, real operation of companies cannot be categorised by one single type.

3. *Direction of innovation*

This aspect examines what kind of novelty the product created as a result of innovation activity represents to the company or the market. The various variations are shown by the following matrix:

³² Resource: DODGSON, M. - GANN, D. - SALTER, A.: The Management of Technological Innovation. Strategy and Practice, Oxford University Press, Oxford, 2008.



11. Figure: Directions of innovation strategy³³

- **Product diversification:** the company tries to satisfy needs of special segments of the market to which proper knowledge of the market is indispensable, the target is to create new types of products. Eg. selling gluten-free flour besides traditional one.
- **Structural innovation** is when the company also tries to satisfy needs of special segments of the market, but in this case creation of a new product-consumption relationship is the aim. Eg. internet access on smart tv.
- **Technological innovation:** its main target is to make operation more effective (it may be structural innovation as well.). Eg. new packaging technology
- **Complex solutions** represent top of innovation activity, they are able to set whole industries a new course, eg. emergence of personal computers.

4. Acceptance of innovation

Technological motivation in case of the four innovation directions does not directly concern market operation of the company since it focuses on

³³ Source: CHIKÁN Attila: Business Economics, AULA Kiadó, Budapest, 2008. 255.p.

internal development. In the other cases harmonisation of marketing and innovation strategy is important so that the market accept the innovation in the way the company expects it. The less the risk of the acceptance of the innovation is, the more the company has the following features:

- **Relative advantage:** The extent the new solution is better than the rest. The bigger this advantage is the easier it is to make the innovation accepted. *Eg. in case of digital camera you do not have to develop the film, pay attention to light sensitivity, etc.*
- **Fitability:** The more consistent an innovation is with existing values, experience and other solutions, the easier to disseminate. *Eg. A digital camera also „looks like” a traditional.*
- **Complicatedness:** The more difficult to understand character of a novelty, the harder it to to disseminate. *Eg. at digital cameras there is automatic function.*
- **Triability:** possibility to try help enhancement *Eg. output of a gadget can be tried in the shop.*
- **Discernibility:** The more we can learn from experience of others, the more it is accepted. *Eg.: on the website of the firm, at forums customers share their experience with others.*

Main criteria determining the success of a strategy

A. Information system of company effectively supporting innovation activity helps with reliable processing of the information about the market from different aspects, coming though from customers, competitors or partners. Paying attention to the following information-sources is especially important:

- Unexpected external event, success, failure,
- contradiction between plans and reality,
- needs of usage processes,
- modification in the structure of industry or market,
- demographic changes,
- change in the attitude of consumers,
- new knowledge of scientific or non-scientific character.³⁴

B. Placing quality in the focus, supporting commitment to quality by all the employees of the company during the innovation activity. Quality of an innovation does not mean technical

³⁴ PAKUCS JÁNOS – PAPANÉK GÁBOR (szerk.): Innovációmenedzsment kézikönyv, Magyar Innovációs Szövetség, Budapest, 2006. 91. o.

perfectness, but quality of suitability to consumer needs. It also concerns employees of partner companies.

C. **Time dimension is getting increasingly important in innovation activity** due to shortening of product life cycles. Therefore parallel development has become widespread in company practice of the past years, meaning that different processes of innovation activities are done coordinated, at the same time (eg. planning, technology development, market launch, etc.)

D. **Common innovation activity** is one of the highest ways of strategic cooperations.

E. Nowadays in innovation activities it is essential that **companies pay attention to externalies**, eg. aspects of the safety of usage, recycling, environment protection.

F. In case during innovation activity **failure can surely be seen, the project must be abandoned forthwith**, to avoid further useless waste of resources.

Managers of the company are key players in fulfilment of innovation strategy. The following managerial skills may positively contribute to the success:

- *He should have kaleidoscope-like way of thinking: he should see the essence in details, should be able to think creative.*
- *He should have visions and be able to communicate them to his subordinates.*
- *He should be able to create coalition.* Because of hurting interest innovation may often cause resistance from the members of the organization.
- *Innovation nowadays is not the success story of lonely wolves.* Results require coordinated work.
- *Success belongs to every participant.*

Structural features of innovation

In spite of the fact that there exists a formal unit and/or structure (eg. project, team) to do innovation activities, it is essential that it be not only their task. **Senior management must support, mediate through exemplary behaviour readiness, skills, vision of innovation to the whole of the company.** There may often occur structural resistance towards innovation, handling of which is also task of the senior management. The reasons of it may be the following:

- Overexaggeration of the existent market or fear of losing it,

- considering innovation insignificant, degradation, narrow-mindedness,
- professional and personal conflicts in innovation process,
- habituality: fear from changes, uncertainty,
- organizational impotence in general.

Factors hindering innovation

According to an article published in Hungary in 2010 the most important factors hindering innovation are unreliable economic environment, quickly changing legal environment and bureaucratic, over-exceeded administration. Distrust between the players of business life, and available internal and external financial resources also considerably restrict innovation activities of companies. During their innovative activity the smallest problem for companies are caused by access to local scientific and technological infrastructure, services supporting innovation and necessary technological information.³⁵

Process of innovation

Innovation is a conscious activity at the companies nowadays, accidental events play little role in it. Consciously planned innovative processes are built on consciously constructed innovation strategy. A necessary and indispensable condition of innovation process is research and development (R&D).

„Research and development means creative work performed regularly the aim of which is to enlarge knowledge including knowledge about people, culture and society and also utilisation of all this material to elaborate new applications. R&D interpreted this way combines three types of activities: basic research, applied research and experimental development”
Frascati Handbook

At R&D expression three types of activities are meant: basic research, applied research and experimental development.

Basic research is experimental or theoretic work the primary aim of which is to gain new knowledge about the essence of phenomena or

³⁵ Source: BAJMÓCY Zoltán – LENGYEL Imre – MÁLOVICS György (editor): Regional innovation ability, competitiveness and sustainability. JATEPress, Szeged, 2012. 52-73. p. <http://www.eco.u-szeged.hu/download.php?docID=27519>

observable facts without tending for any application or utilisation Eg.: *in 1938 Otto Hahn invented nuclear fission,*.

- ☐ Two subtypes of this activity are **pure basic research** and **aimed basic research**: direct social or economic yield, or solving practical problems are not purpose of the previous one, while in case of the latter one it is possible to serve for the solution of recognised or expected, present or future problems.
- ☐ *Applied research* is also original research aiming at gaining new knowledge. However, it is done to implement a certain practical aim or idea. Eg. *Enrico Fermi and Leo Szilárd created the first atomic pile in Chicago, in 1942.*

Experimental development is systematic effort, based on existing knowledge from research or practical experience, directed toward creating novel or improved materials, products, devices, processes, systems, or services and thorough further development of already produced or launched products, tools, etc.³⁶ Eg. *the first atomic bomb was elaborated in 1942-45 and a nuclear power station generating electric energy was built in US in 1952.*

At a company usually not only one innovation process is going on, but paralelly several ones. These processes may join each other in several lines, making the development processes even more complicated. The aim of innovation activities is usually of two types: the previously mentioned technology pushed and market pulled types. During the past 60-70 years several theories have been born on the evolution of innovation processes, description of these innovation process models will be discussed in the next part. Summary of the certain models are in the following chart:

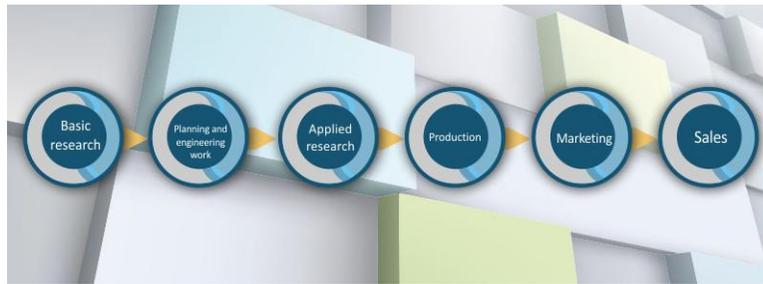
³⁶ OECD: Frascati Handbook, 2002. 25.p.

Generation	Period	Name	Features of the model
1.	end of 1950-1960-ies	Technology Pushed model	Linear process, dominance of R&D, role of market is negligible
2.	end of 1960-ies- first part of 1970-ies	Market pulled model	Linear process, dominance on market, R&D has reactive part
3.	second part of 1970-ies –and of 1980-ies	Interaction model	Innovation is supported by common interaction of R&D, production and market
4.	1990-ies	Net model	Integration is spread to the integrated company information systems, too. Common integration role of strategic associations is increased
5.	end of 1980-ies- beginning of 1990-ies	Integrated model	External cooperation of the company is integrated in the internal processes, parallels
6.	2000-s	Open innovation	Open system with many players, interactive connections, participation of various developers, suppliers, consumers and other players, due to their horizontal and vertical connections interactive value-creation is fulfilled

12. Figure: Historic review of innovation models³⁷

1. The concept of *technology pushed model* is created as a result of a general process: the researchers make inventions thanks for basic researches which are used by experts to elaborate product ideas based on which engineers and designers plan and create the prototype which can be tested. Efficiency of production is competence of production process. At the end of the process marketing and sales does advertising and sells the product to potential customers.

³⁷ Source: KOTSEMIR, MAXIM - MEISSNER, DIRK: Conceptualizing the Innovation Process - Trends and Outlook, MPRA Paper No. 46504, posted 24. April 2013., 5.p. <http://mpra.ub.uni-muenchen.de/46504/>



13. Figure: Process of technology pushed innovation³⁸

Basic research – Planning and engineering work – Applied research – Production – Marketing - Sales

2. Base of *demand pull model* is close relationship of company marketing with customers. Marketing unit gets ideas from signals of the market which are forwarded to R&D unit for planning and development and the product is sold after production.



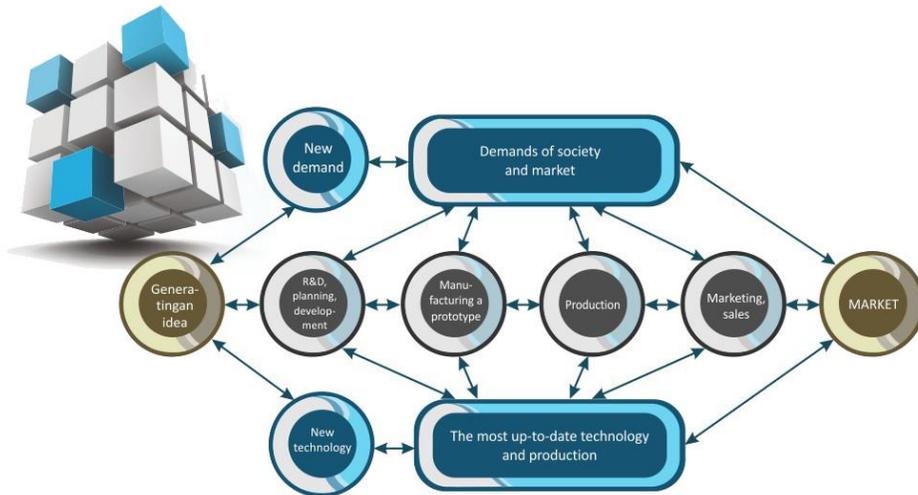
14. Figure: Process of Demand Pull Model³⁹

Market demand – Marketing – Development – Production - Sales

³⁸ Source: ROTHWELL, ROY: Towards the fifth-generation innovation process., International Marketing Review, 1994., Vol. 11. Issue: 7. 7-31. p.

³⁹ Source: ROTHWELL, ROY: Towards the fifth-generation innovation process., International Marketing Review, 1994., Vol. 11. Issue: 7. 7-31. o.

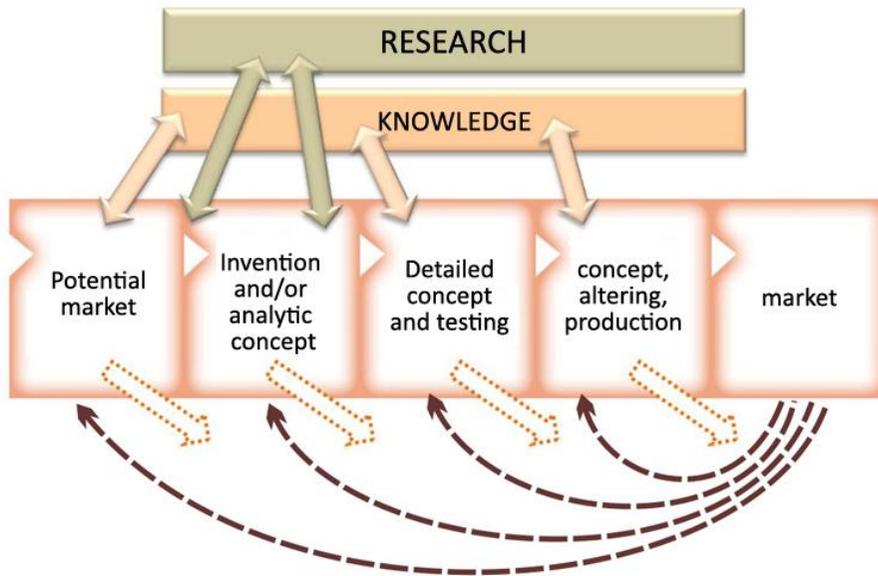
3. According to *interaction model* innovation is enhanced by simultaneous, joint use of the following functions. Innovation had a fix starting point in linear models of the previous periods, in this model it is not that clear.



30. Figure: Interaction modell⁴⁰

4. In *Integrated model* external partners (suppliers, strategic partners) are actively involved as well. Innovation process embodies elements of different activities the starting point of which is that companies recognise market, business opportunities thanks for research or other effects. In iterative way – based on continuous feedback- product ideas and conceptions are elaborated, tested, the new product is manufactured and launched in the market.

⁴⁰ Source: ROTHWELL, ROY: Towards the fifth-generation innovation process., International Marketing Review, 1994., Vol. 11. Issue: 7. 7-31. o.



31. Figure: Integrated model⁴¹

5. The concept of *net model* is that creation, spread and succes of modern technical solutions increasingly depends on combination, mutual connections of actors and „knowledge fields” of heterogenous composition. Nowadays majority of companies are unable to manage to develop all the relevant technologies, therefore they turn to external „knowledge-sources”, try to involve them in their internal processes creating this way complex connection structures. Cooperation of economic, social players, their combinations at various levels, in various forms and content creating connection resources (social capital), network competence, network system influences possibility of successful innovation at a certain level. It creates organisational bases for cooperation at the entrance side, it coordinates and makes innovation processes smoother within the system, and helps its spread at the exit side. Besides companies other organizations,

⁴¹ Source: KLINE, STEPHEN – ROSENBERG, NATHAN: An Overview of innovation. In Landau R, Rosenberg N, editors. The Positive Sum Strategy: Harnessing Technology for Economic Growth. Washington, DC: National Academy of Sciences. pp. 275-306. [ftp://ftp.ige.unicamp.br/pub/CT010/aula%202/KlineRosenberg\(1986\).pdf](ftp://ftp.ige.unicamp.br/pub/CT010/aula%202/KlineRosenberg(1986).pdf)

institutions are also involved in this net, the most important ones are as follows:

- Business and innovation centres
- technology transfer organizations
- technopolises, science and technology parks, technology centres
- expert/excellence centres
- institutions for enterprise development (incubator houses, industrial parks)
- institutions of higher education and research
- organizations of knowledge base
- private business servicers, consultants.⁴²

6. *Open innovation* is utilisation of targeted in- and outflow of knowledge between the company and its environment in order to speed up inner innovation and expand markets for its external utilisation.⁴³ Open innovation basically is opening external borders of the company in front of in-and outflow of information, knowledge and technology.⁴⁴ The greatest advantage of open innovation is that it takes the company a lot shorter time to find new markets than without open innovation aspect, besides it is easier to achieve new technologies and new ideas and competencies are also easier to access. Other advantages of open innovation are cost decrease and cost efficiency.⁴⁵

6.3 SUMMARY, QUESTIONS

6.3.1 Summary

Innovation is a new way of satisfying consumer demands in higher quality than before. Function of information is to create solutions suitable for satisfying increasing consumer demands. The main reason for innovation becoming of strategic importance is competition between

⁴² CSIZMADIA Zoltán: Net base approach of innovation, In: Hardi T, Nárai M (editor) Space structure and space processes: Study volume a homage of Rechnitzer János . Pécs; Győr: MTA KRTK Institution of Regional Researches, 2012. pp. 125-146.

⁴³ PÖRZSE Gábor: Research Organisation and Innovation Management in Health- and Life Sciences, Semmelweis Kiadó, Budapest. 2011. 22. p.

⁴⁴ CHESBROUGH, HENRY - CROWTHER, ADRIENNE K. : Beyond high-tech: early adopters of open innovation in other industries. R&D Management, 2006.Vol.36, No.3, 229-236. p

⁴⁵ CHESBROUGH, HENRY - CROWTHER, ADRIENNE K. : Beyond high-tech: early adopters of open innovation in other industries. R&D Management, 2006.Vol.36, No.3, 229-236. p

companies. Its main feature is consumer orientation, novelty and uncertainty. It can be embodied in creation of a new product/service, new technology, new organization, its extent may be radical, or incremental change. It may be initiated in technology pushed or demand pull way. In creating, implementing innovation strategy the company has to have close cooperation with its environment and all the stakeholders. Depending on whether the innovation strategy creates novelty for the company or the market (or the combination of the two), four basic types can be distinguished. Research and development process which practically is the frame of innovation process is research built up from research aiming at enlarging knowledge and development aiming at its application. Innovation processes have gone through radical changes during the past 60-70 years, six types are distinguished from these models.

6.3.2 Selfcheck questions

- Specify the three basic features of innovation!
- Classify innovations by various aspects!
- How may external stakeholders influence innovation activity of the company?
- Distinguish radical innovation from incremental!
- Distinguish innovations by their directions!
- What factors may decrease risk of acceptance of innovation?
- What is R&D, and what subactivities can it be divided?
- Distinguish technology push and demand pull innovations!
- Characterise net and open innovations!

6.3.3 Practice tests

- 1 Radical innovation means development in small steps, eg. only minor element of the technology or product is altered. FALSE
- 2 When product diversification the company wishes to satisfy a special segment of the market to which thorough knowledge of the market is indispensable. TRUE
- 3 Unexpected, accidental inventions play important role in current innovations. FALSE
- 4 At a time only one innovation process goes on at one company. FALSE
- 5 The concept of technology pushed innovation is that it emerges through the following general process: the researchers make inventions thanks for basic researches which are used by experts to elaborate product ideas based on which engineers and

designers plan and create the prototype which can be tested.
TRUE

- 6 The concept of open innovation is that it takes the company a lot shorter time to find new markets than without open innovation aspect, besides it is easier to achieve new technologies and new ideas and competencies are also easier to access. TRUE
- 7 Interaction innovation model breaks up with aspects of linear innovation processes. TRUE

7. HUMAN RESOURCES MANAGEMENT OF A COMPANY

7.1 OBJECTIVES AND COMPETENCIES

Although role of human resources (human capital) in the economy was discovered already in the 18th century by English economists (eg. Smith, Ricardo), its importance got into the focus of attention only in 1950-s, 60-s.

- By the calculations of R. Solow 87% of the doubling of work productivity from 1909 to 1949 can be attributed to the effects of technical development⁴⁶
- Becker considered childraising and education as investment applied in the hope of future yield the increment of which may considerably contribute to economic growth in the future.⁴⁷
- T. Schultz appointed that professional skills, knowledge and development of skills have outstanding role in the efficiency of labour. Work ability is created by individual and social investments the personal yield of which (eg. higher wages, better life conditions) and social yields (eg. social welfare, economic growth) are both important. Investment in human capital by Schultz are the following:
 - education (basic-, intermediate-, higher)
 - trainings at- and outside workplace
 - migration
 - healthcare expenses
 - research⁴⁸
- Denison says that about 2/3 of economic growth in the US between 1948 and 1981 was originated from education, increase in knowledge and innovation.⁴⁹

This unit is dealing with responsibilities of employees, those who are internal stakeholders within the company and their relationship with

⁴⁶ SOLOW, ROBERT M.: Technical Change and the Aggregate Production Function, The Review of Economics and Statistics, Vol. 39., No. 3 Aug., 1975.

⁴⁷ BECKER, GARY S.: „An Economic Analysis of Fertility", Demographic and Economic Change in Developed Countries, a Conference of the Universities, National Bureau Committee for Economic Research. Princeton, NJ: Princeton University Press., 1960., p. 209-240.

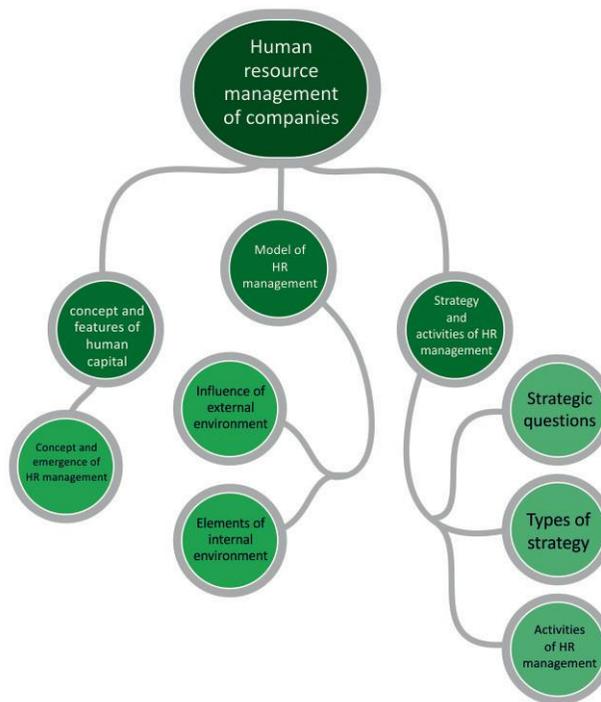
⁴⁸ SCHULTZ, THEODORE W.: Investment in Human Capital, KJK, Budapest, 1983

⁴⁹ SAMUELSON P.A. – NORDHAUS W. D.: Economics III.: Applied Economics in our World, KJK, Budapest, 1989.

other stakeholders. Students must know concept and characteristics of human capital. They should know concept of human resource management and be able to distinguish its stages in the company. They are expected to know elements of HRM model, factors influencing internal and external management, its activities, basic tasks and results to be achieved. They should know main strategic questions of HRM and should be able to characterise the main types of the strategies. Students must be aware of the basic processes, activities of HRM.

7.2 CURRICULUM

In the first part of of the unit concept and characteristics of human capital will be discussed, then models dividing the responsibilities of human resource management in five periods will be examined. Starting point of the currently relevant model of human resource management is examination of the elements of external and internal environment. Having thoroughly studied them it is possible to set strategic targets and determine basic tasks and activities. Human resource strategies are discussed in main groups. In the last part of the unit the most important activities of human resource management will be reviewed.



32. Figure: A human resource management of companies

7.2.1 Concept and features of human capital

Human capital can be defined in various ways, some of them are as follows:

- Investment of money and time in education, knowledge accumulated during education.⁵⁰
- Knowledge, experience and professional skills are a form of capital, part of organizational property. It is expensive to function, develop and needs substantial investments from both the individual and the organization.⁵¹

⁵⁰ KŐVÁRI György: Management with Human Resource , Országos Munkaügyi Központ, Budapest, 1991. 10. p

⁵¹ KŐVÁRI György: Management with Human Resource , Országos Munkaügyi Központ, Budapest, 1991. 10. p

- A form of capital. Human, because it becomes part of humans, and capital, because it is source of satisfying future needs and/or earnings.⁵².

Human capital can be related to other resources in several fields:

- human capital is an element of market economy, its subjects make connections according to the rules of market behaviour (labour market demand and supply),
- value of human capital is determined by market conditions,
- investment in human capital is utilised by its owner hoping for yield,
- it has determined capacity and its output offer is determined.

However, human capital has numerous other characteristics which make it different from other resources:

It does not worn out with time, on the contrary to all other resources – that run out in their application – it exists on long term. Education is more durable than most forms of non-human, reproducible capital, so a given gross investment increases the staff more than the same gross investment in non-human capital stock.⁵³

- With the help of developing programmes capacity of human resource can even be intensified by time.
- It is not possible to make reserve from it, because the capacity not utilised at the given time is lost, it cannot be used at a later production. In order to utilize human resource efficiently, this feature requires planned, continuous and even load.
- Man is an individual with independent, free will, able to regulate his actions, so his output as well (he can leave the organization by his own will, has ability for regeneration, he is not property of the organization). These features can substantially be influenced by motivation.⁵⁴

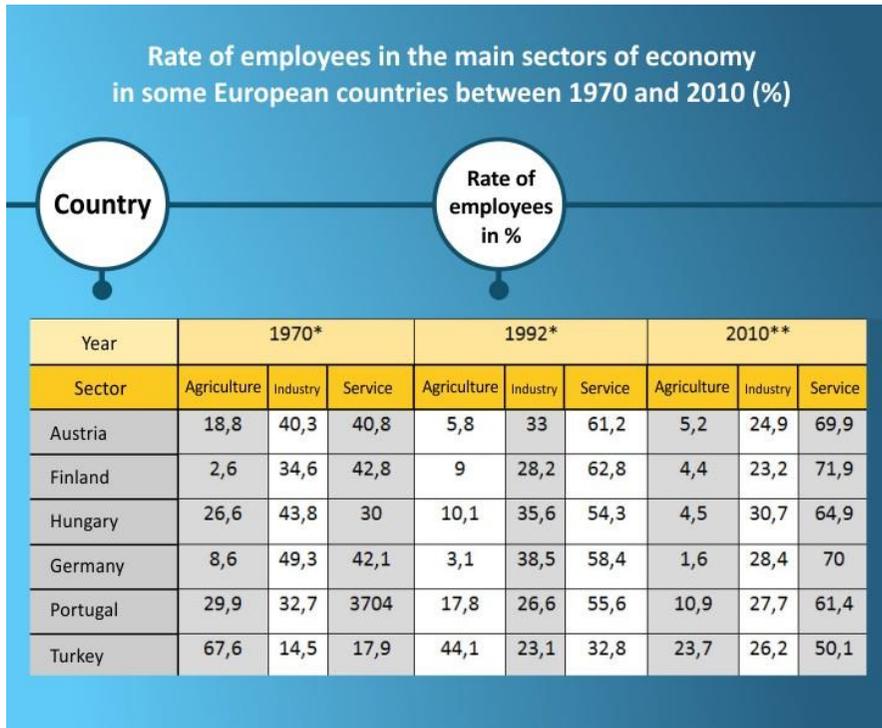
In the past decades importance of human resource in economies has substantially increased as a result of technological and social development. Economic structure has largely changed which result is usually called knowledge based economy. The tendency that the role of industry is decreasing and leadership is given over to services is going

⁵² SCHULTZ T. W.: Investment in Human Capital, KJK, Budapest, 178. p.

⁵³ SCHULTZ T. W.: Investment in Human Capital, KJK, Budapest, 1983. 141. p

⁵⁴ BERDE Csaba – HAJÓS László (editor): Human Resourch Management, DE AMTC AVK, Debrecen, 2007. 21. p.

on at the beginning of the 21st century. In the case of the countries in the following chart it can be seen that proportion of tertiary sector, though in different rates, has been increasing in employment in the past forty years.



33. Figure: Rate of employees in the main sectors of economy in some European countries between 1970 and 2010 (%)⁵⁵

Human capital has increasing role in services in terms of competitiveness and company value compared to physical or financial capital. Nowadays human resource has become the most important factor in efficient operation and competitiveness of organizations, which is the only one to be able to handle technological challenges consciously and utilize target orientedly the possibilities offered by them in the interest of successful and efficient operation of the company. These days

⁵⁵ Source: VÁNYAI Judit – VISZT Erzsébet: Increasing Role of Services Közgazdasági Szemle, XLII. year., 1995. 7-8. issue. (776-787. p) *, Labour Market Statistic 2011 Edition, EUROSTAT **

more and more managers realise that managing human resource is not only an organisation function, but may be the key to company success.

7.2.2 Concept and emergence of human resource management

Due to appreciation of human factor an increasingly bigger proportion of companies consider managing human resource of key importance, this way it gets important role in company management as well.

- ☞ **A combination of functions built on each other in organizations which enhance efficient utilisation of human resource taking individual and organizational objectives into consideration is called human resource management.⁵⁶**
- ☞ **In another way: The function of management which deals with people working for the organization as its essential (strategic) resource. The aim of its activity is to ensure the most efficient and most practical employment of its employees in order to implement objectives of the organization and employees at high level.⁵⁷**

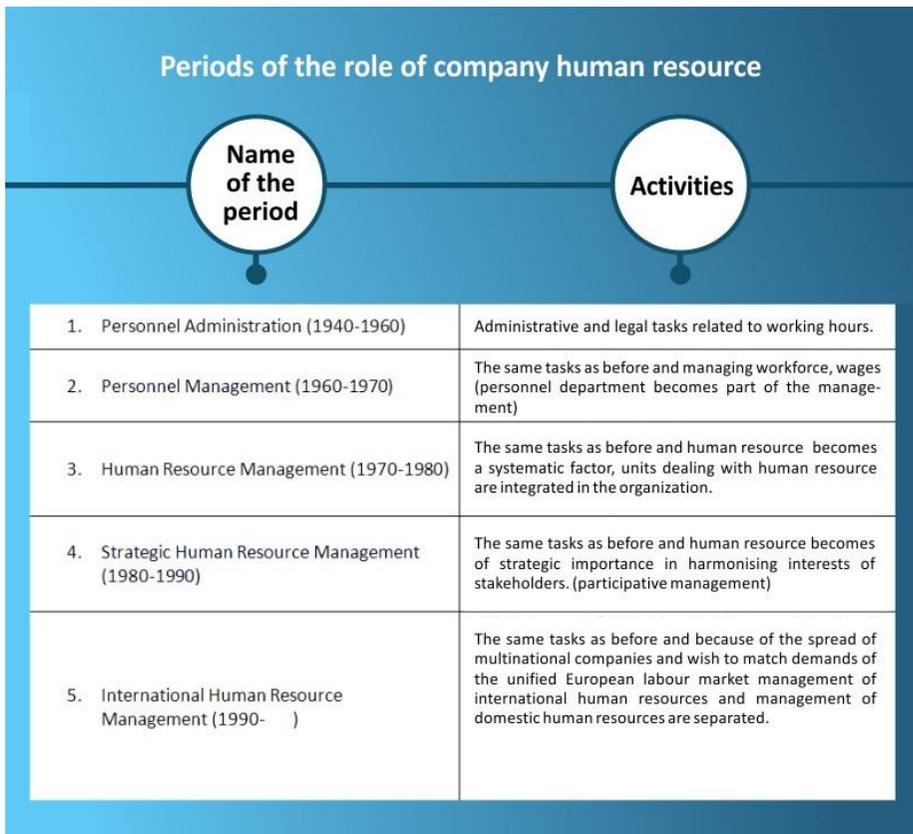
According to Miklós Dobák human resource management (HRM) is aimed at supporting creation and implementation of organizational objectives and also supplying continuously the organization with suitable quantity and quality of workforce. The ultimate objective is insuring organizational efficiency which results in long term existence and development, growth of enterprises.⁵⁸

The changes of the role of human resource in time is divided by Peretti in five development sections:

⁵⁶ POÓR József – Farkas Ferenc: International Management. KJK-KERSZÖV Jogi és Üzleti Kiadó Kft., Budapest, 2001., 223-224. p.

⁵⁷ VÁMOSI Zoltán: Human Resource Management, LSI Oktatóközpont, Budapest, 2004.

⁵⁸ DOBÁK Miklós: Structural Forms and Management. Közgazdasági és Jogi Könyvkiadó, Budapest., 1999., 140-144 p.



34. *Figure: Periods of the role of company human resource*⁵⁹

7.2.3 Model of human resource management (HRM)

The model of human resource management can be seen in the following figure. Influencing elements of external environment, effects of internal environment and activities of HRM are discussed in the next subparts.

⁵⁹ Source: PERETTI J-M.: *Fonction personnel et management des ressources humaines*, Vuilbert, Paris, 1990. 573.p



35. Figure: Model of human resource management (HRM)⁶⁰

Influencing elements of external environment

They influence the company indirectly, in short term culture, social standard, traditions, while in long term means of economic policy are more determining.

A. *General processes of macroeconomics: For example::*

- productivity conditions of the economy,
- economic growth, stagnation, decline,
- conditions of market competition

B. Labour market:

⁶⁰ Source: Own chart, GYÖKÉR Irén – FINNA Henrietta – KRAJCSÁK Zoltán (2010): Human Research Management (educational supply), BME GTK Üzleti Tudományok Intézete, 2010. by http://bme.ysoft.net/GTK_MuszakiM_MSc/S1_Emberi_eroforras_menedzsment/Emberi%20er%F5forr%E1s%20menedzsment.pdf

- demand and supply conditions – oversupply¹³⁴ the labour market is favourable for the organizations,
- structural differences between demand and supply in workforce – eg. too many lawyer, too few engineers.
- quality of workforce.

C Geographic location of the company: It may have great influence on demand and supply conditions of workforce, as labour market is usually local market.

D Legislation and regulation: The government and local governments have significant influence on companies through law, acts, and regulations.

- eg. the Labour Code, minimum wages, employment regulation,
- extent of taxes and contributions charged on employment and wages.

E. Labour connections: They act as advocacy of employer and employee associations in agreements of the social partners, therefore most human management activity involves mutual decision making¹³⁴ least acknowledgement based management. The advocacy organizations influence decisions of this area in directly too by taking part in creation of labour law acts and regulations.

Influences of internal environment

Without being complete the following can be mentioned:

- A. Internal processes of the organization:* If the venture expands, changes or decreases, its market position gets worse, the objectives of human resource management and the service activities to supply it will change as well. Demand for workforce will increase or decrease, quality, structure of required skills will change so redundancy or recruitment will be necessary, the organization may need training, etc. Besides these internationalization may become dominant at HRM aims and activities or also cultural change, altering management philosophy or managerial style may occur due to changes in technology.
- B. Regulation within the company:* By regulation we mean ways of cooperation of people, groups, units, changes of the essential features (centralization, decentralization) of the organization, characteristics of organizational structure and their changes. Based on it responsibilities undergo transformation, people become redundant at certain areas, while at other places new demand occurs for employees having certain skills.

- C. *Structural strategy* Base of the future operation of the enterprise is represented by organizational and business strategy, integrant part of which is human strategy. Human resource planning and plans of necessary sub-activities are based on it.
- D. *Local employee associations*: Existence, strength, quantity, way of operation of advocacies, trade unions within the company also influence HRM activities. It mostly has effect on reconciliation mechanisms and methods. Intra-communication system thoroughly influences quality, efficiency of inter-employee connections.

7.2.4 Strategy and activities of HRM

Similarly to other functional activities it is valid for human resource management as well that its strategy, basic operation theories come from the message and strategy of the company. To see this sequence, key questions of HRM strategy must be clarified first.

Strategic questions of HRM

Based on resource-based company theory main strategic questions of HRM are as follows:

1. From which sources can the company ensure on long term its human resource from matching its strategic objectives both in quantity and quality?

- *Acquisition from internal labourforce*, the main methods of which are eg, reorganisation, regrouping, calling back eg. pensioner, tender or training within the organization, career planning

Advantages: lower cost, shorter time, less risk (the person is known), the promotion is stimulating

Disadvantages: narrower choice, partiality, inner interlacements

- *Acquisition from external labourforce*: if the company cannot or does not want to satisfy its workforce need, it creates workforce demand on the labour market.

Advantages: wider choice, a new employee coming from outside may bring new and innovative ideas with himself, the „outer“ may recognise mistakes, disorders more easily, he is less effected by previous customs and other negative group effects, sometimes it is cheaper to employ a ready, trained and proficient expert.

Disadvantages: higher purchase costs, higher rate of outcomers may stimulate migration, blocking promotion possibilities, due to the previous ones negative effects on work atmosphere, higher risk of pay-off

(probation is necessary), lack of organizational knowledge (it takes time to acquire)

☞ **Demand for labourforce: Part of labourforce demand appearing on the labour market.**

Advantages: bigger choice, flexibility, competitiveness, fresh, new ideas, more open company culture

Disadvantages: higher cost, often lengthy, higher risk (the person is not known)

2. Should positions or individuals be the building stones of human resource system?

- If compensation is built on values of the position, trainings aim at acquiring skills necessary for taking a position. The primary aspect at recruitment is position match.
 - *Advantages:* lower running costs, easy to plan, transparent, standardizable system.
- If the system is built on individual skills, then potential match of the candidate to the whole organization (culture) is considered at recruitment.
 - *Advantages:* flexibility, loyalty, open, participative culture

3. Individuals or groups should be in the focus of human resource management?

- According to traditional concept the company concentrates on individuals: individuals are recruited, trained, evaluated, incented.
- According to group-centered concept team tasks are assigned, training, evaluation, motivation is done in groups. This latter method is becoming widespread in several industries.

4. Performance- or competence based approach should be applied?

- The previous one focuses on performance motivation, better transparency, while the latter one concentrates on development orientation, professionalism and long term loyalty.

Types of HRM strategy

Bolwijn and Kumpe distinguished four types of company strategies based on primary operation philosophy of the firm.

Company strategies and HRM theories				
	STRATEGY FOCUS			
	Efficient company	Company aiming quality	Flexible company	Innovative company
Main aim	cost reduction	quality	flexibility	innovativity
Expected personal requirement	precision	consumer orientation	adaptibility	creativity
Methods of organizational management	regulations, rules	motivation, persuasion	quick, effective communication	change management

36. Figure: Company strategies and HRM theories⁶¹

1. **Efficient company:** Its main target is to reduce costs to be mostly achieved by size thrift. The organization is hierarchic, bureaucratic and rational, their main means of coordination are planning and control, it works smoothly.

HRM principles:

- The employee should adapt to the task, means to achieve it: detailed job descriptions, specialized functional trainings, thoroughly elaborated assessment systems.
- Employees are approached by **Taylor** theory: employees are replacable parts of the process, cost factors.
- Well traine employee is a precondition to sustainable growth.
- Functional specialization is characteristic at both manual and white-collar staff.
- Functions are carefully separated, HRM operates as social enginner.
- Manual workers and administrative staff are treated in completely different way.
- Relationship of employers and employees is ruled by untrust.
- Work is done strictly ba regulations, loyalty is a basic requirement.

2. **Quality orientated company:** both senior management and employees think quality centered, constant development is

⁶¹ Source: BOLWIJN P. T. – KUMPE T. : About facts, fiction and forces in Human Resource Management, Human Systems Management 15 (1996) 161-172. p. IOS Press

characteristic, there is close relationship between development and production. Employees are motivated, positive stimulation is typical. The main coordination tools of the company are communication and cooperation, not the organization, but culture is in the center.

HRM principles:

- Employees take part in quality programmes, the centre of activity is consumer orientation.
- The target is to increase communicative skills, managerial style.
- HRM concentrates on needs of various members of the organization, encourages rotation of positions.
- The aim is enrichment of the position, team work.
- The management, especially senior management is separated, employees do not take part in their assessment.
- The stimulation system also here is built on quantity figures, soft dimensions (inner conditions of work) are not paid attention to.
- Participation, democracy rarely works.

3. **Flexible company:** the objective is to increase operation speed, the fastest possible satisfaction of consumer needs. The main coordination means are integration and decentralization. There are few hierarchic levels. Management is process orientated.

HRM principles:

- Entrepreneurial type managers are needed, risktaking is encouraged.
- Multifunctional teams are created, manual and administrative employees are not distinguished.
- Internal movement, rotation of employees is considerable.
- It is a problem, that seeking quick achievements often results in *macho-management*, business inspired inner connections while soft factors of management are neglected: shifting from control to loyalty is often just theoretical.

4. **Innovative company:** the main objective is seeking striking novelty, otherness. Their main means of coordination are participation and democracy. Wide range of products, seeking market niches. Multifunctional ad-hoc work teams are characteristic, internal hierarchy changes accordingly. Team motivation is frequent, assessment of the employee is done by knowledge and hierarchy. Technical and sociological renewal are inseparable, the atmosphere stimulates creativity.

HRM principles:

- It has crucial role in the process of constant changes.

- Experiments and constant search for new work systems.
- Eccentrics, people with special knowledge are welcome.
- Due to the loosening of hierarchy they look for new motivations and new conflict solution algorithms.
- It is a problem that effects of sociological changes are often undervalued.
- Difference between managers and non-managers decreases.
- HRM must find balance between representation of managerial values and democratic processes.⁶²

Activities of human resource management

Functional activities of HRM reflect human strategy, policy of the management. Part of their typical activities serve creation of harmony between jobs and employees indirectly (eg.human resource planning, position assessment), others directly (eg. recruitment, choosing, motivation).

1. *Determining labour force needs*: it contains three major steps:
 - A. By business strategy – forecast for quality and quantity needs of human resources
 - B. By proper forecasts coming from internal and external environment – to determine activities guaranting acquiry of competences and necessary staff in the future.
 - C. Analysis, creation and assessment of job titles: After dividing work processes to work tasks the tasks are assigned to jobs.

 **Job title: Part of company work tasks assigned to one person demanding application of defined knowledges and skills.**

-  Creations of jobs can be done by various principals. By systematic analysis of jobs can be determined requirements necessary for successful completion of work tasks. This way tasks, work environment, organizational structures, requirements for work (physical, mental and brain) are analysed and compensations attached to them influencing behaviour, satisfaction of the needs of employees are determined. Assessment helps with creation of inter-job priorities, job classes.

⁶² CHIKÁN Attila: Business Economics, AULA Kiadó, Budapest, 1999., 263-266.p.

2. *Recruitment of workforce*: its aim is to find the most suitable people to do jobs and to perform notice (dismissal) activities

A. *Recruitment of workforce*

Candidates may come from within the company – it leads to the issue of workforce development – or from outside – it is called workforce recruitment.

Recruitment of workforce: besides general attraction it considerably depends on workforce-market conditions. If there is overdemand on the market, then it is usually the company which has to make efforts to get workforce, while in case of oversupply it may expect workforce to contact the company either directly or eg. through employment bureaus.

Selection may happen in different ways and can be influenced by several factors. Applicable procedures: personal interview, various tests, surveys, number of reference arrangement alternatives are available for decision makers.

- ☐ When starting the job the first information, impressions can be crucial. Also an important issue is who can decide on applying the new workforce.

B. *Dismissal*: It is unavoidable part of workforce management. It can be temporary or final:

Temporary: if the company thinks they may need the dismissed employee later.

Final: if the company does not wish to employ the dismissed employee later.

- A natural reason to depart an employee is retirement.
- Cutback itself rarely leads to long lasting competition advantage.
- It is important experience that cutback should be made in one big wave if possible, not in sections.

3. *Development of work organisation and human resource*:

A. *Work organisation*: The employee must exactly know what tasks he has to do and with whom and how he should cooperate. During the activity job title is needed to be widened, work conditions to be improved, new work organisation procedures to be applied, eg.:

- change in, more flexible work schedule, possibility to do work at home.

- work rotation which makes it possible that employees, within their professional skills, perform different tasks even during a day.
 - when widening work tasks employees perform tasks different only in their features.
 - non-full time employment having different forms: part-time job, application of free-lancers, involving sub-contractors.
 - team work enforces both internal and external motivation
- B. Career planning and retrainings: Personalised career planning or elaboration of career and insuring continuous up-to-date knowledge, the types of which are: education in school system, through employment bureau, at the company. Groups concerned: managers, career reserve, new entrants.

4. *Motivation, waging, incentives:*

- A. *Motivation:* stimulation aiming at satisfaction of human needs due to which man is willing to start activity in the interest of the target.

- ☐ Strength of motivation mostly depends on the award the person can get when achieving the target.

- Motivation of employees is a complex task, its aspects are:
 - Experience has shown that internal motivation is more effective, more stabil for employees, however, the company can only apply external means of motivation.
 - Motivation is not objective, the employee does not match real input with real output and an award having objective value, but experiences and also evaluates them subjectively.
 - Performance boosting effect of the award is not unambiguous either. It is empirically proven fact that sometimes satisfaction with the award not increases, but rather decreases work performance.
 - Different means of motivation can be applied and certain means may have different effects on various groups of employees. Obviously different employees stand on different levels of need-hierarchy, so they are of different valuation of the same bonus.
 - A most important indicator of successful work of management is high level motivation of employees. Every employee is different, they react in different ways to various effects. People are less and less contented with financial motivation efforts.

- **Features of a successful motivation system:** besides financial incentives the following features are expected to be present:
 - many-sided, interesting job
 - participation in decisionmaking
 - fair waging
 - promising career
 - possibility for self-expression and self-development
 - communication system, management culture to the liking of the employee
 - attractive organizational structure
- B. *Performance assessment:* Periodical, usually oral discussion of managers with individual employees aiming at their assessment, the functions of which are:
 - If well done it can help to determine whether the employee is at the right place in the given job.
 - It helps with creating personalised trainings.
 - With its help income level and structure to be given can be decided.
 - It gives base for assessing human resource strategy and practice of the company.
- C. *Waging:* Incentive system from the aspect of employees is the whole bulk of return services of essential importance.

Factors considered when creating incentive systems: job requirements, content of the work or employee-market supply-demand conditions.

- A most difficult task is to create wage and compensation system competitive and attractive on labour force market reflects well differences coming from jobs and individual or group performances, but at the same time it does mean too big a burden for costs either.
- Wages- and income policy of company management is characterised by duality. On one side they try to increase revenue, on the other side payments for employees appear as costs decreasing profit.
- Wages and income policy must consider various aspects:
 - Incomes of employees, as cost factors must be considered in financial strategy of the company. Sum to be spent on wages and other payments must be defined.
 - An earning structure must be created which are accepted by employees as fair concerning income proportions within the

company and also compared to colleagues having similar jobs at other companies.

- Recently non-money incentives have come into foreground: they are in kind allowances given by the company to its employees for their work. To choose means of motivation the company has a rich variety to use non-money allowances. The most important groups of allowances are as follows:
 - insurances
 - in kind allowances
 - pension fund
 - paid holidays, vacation
 - social allowances
 - loan guarantee, reductions, etc.

7.3 SUMMARY, QUESTIONS

7.3.1 Summary

Human resource management deals with a most important resource of the company, - at the same time with a circle of internal stakeholders – employees. Due to the social and technological development of the past decades economic importance of human resource has increased. Properly motivated, skilled, creative, experienced workforce able to work independently may mean competitive advantage – and may become of strategic importance for the company. Human resource management activities are influenced by culture, traditions, social standards on long term, while on short term they are mostly affected by means of state economics policy. From among internal factors the most important ones are organizational processes, like organizational regulation, strategy of the organization and role of local employee associations. Depending on the objectives of company strategies, strategy related to human resources may be different, too. The most important activities of human resource management are as follows: defining workforce needs, application of workforce, development of work and human resource, motivation, wageing, motivation.

7.3.2 Self-check questions

Describe concept and features of human capital!

How have activities related to human resource changed at companies since World War II ?

Draw and describe human resource model!

What external environmental factors is human resource management affected by and how?

What internal environmental factors is human resource management affected by and how?

Describe the main strategic questions of HRM and possible answers to them!

Distinguish companies by their human resource strategy!

Describe the activities related to determining workforce need and workforce application!

Describe types of new work organisational procedures!

Describe company activities concerning motivation, wageing, incentives!

7.3.3 Practice tests

- 1 Creation of job titles at companies is done by unified aspects. FALSE
- 2 Work rotation makes it possible that employees within frames of their skills can perform different tasks even during one day. TRUE
- 3 In successful motivation systems besides money allowances also non-money allowances play important role. TRUE
- 4 The following factors also must be considered when creating incentive systems: job requirements, content of the job, or workforce-market supply-demand conditions. TRUE
- 5 When employees are contented with bonus, it always increases work performance. FALSE
- 6 Identical means of motivation may have different effects on employees in different groups. TRUE
- 7 At innovativ companies multi-functional ad-hoc teams are typical, so internal hierarchy varies accordingly. Team motivation is frequent, the employee is assessed by his knowledge and hierarchy. TRUE

8. SOURCES OF COMPANY INFORMATION, THEIR ROLES AND COMPANY INFORMATION SYSTEM

8.1 OBJECTIVES AND COMPETENCIES

Nowadays use of the concept of information society is frequent not only in Social Sciences but players of business life also refer to it. In the past years several definitions have been created to explain it, but they usually concentrate on one single aspect. Here we will only mention those having economic aspect as well.

„In a society in which (...) information is used as economic resource, the community better utilises it and behind an industry is being developed which provides necessary information ...” (Nick Moore)⁶³

„A society which organises itself around knowledge in order to handle social control, innovation and changes...” (Daniel Bell).⁶⁴

The aim of the unit is to get students acquainted with basics of company knowledge management and information management. Students are expected to know concept, features of knowledge, be able to distinguish its types. They must know tasks of company knowledge management and steps of its integration into company strategy. They should be able to distinguish structural elements of knowledge capital and know their relationship. They are expected to know concept of company information system, be informed about characters of information needs appearing at various management levels. They must know main stages of the development of information systems, distinguish features of island systems and integrated systems. They must know the main elements of modern integrated company managements systems, their main functions, relationships.

⁶³ MOORE, NICK: The information society, In: World Information Report 1997/98, Unesco Publishing, 271-272. p.
<http://www.unesco.org/webworld/wirerpt/wirenglish/chap20.pdf>

⁶⁴ Z. KARVALICS, LÁSZLÓ: Information Society – What is it? Meaning, History and environs of an Expression , In: Pintér, Róbert: From Theory to Political Practice, Tankönyv, Gondolat – Új Mandátum Kiadó, Budapest, 2007., 34.p.

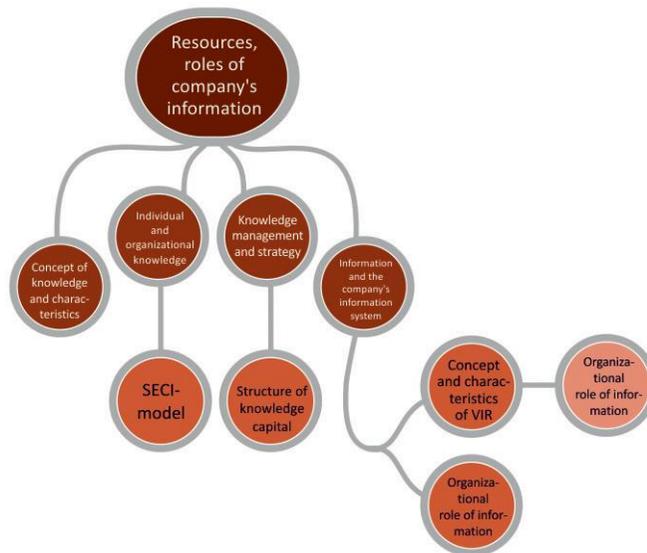
8.2 CURRICULUM

If we take eg. a smart phone in our hand, it is not sure that we realize that majority of this gadget is mostly made up of not traditional resources, like raw material or workforce, but a row of top technologies stuffed into this handful equipment. We may say without exaggeration that value of these „hightech” tools is mostly given by the technology built in in integrated form by the manufacturing firm. The basis of knowledge is information which has boomed in the past two decades. Science Magazine published an interesting article in connection with it in April 2011:

- All store information of mankind in 2007 was 295 exabite ($2,72 \times 10^{21}$ bit) (in comparison information content of all cell DNA of humans is about 10^{23} bit).
- Data amount stored on digital storage has exceeded information amount stored analogue way since 2002. In 2007 94% of all the information was stored in digital way.
- Between 1986 and 2007 operation output of computers annually grew by 58%: it is ten times faster than the growth of the GDP of US at the same time. However, data transmitted by telecommunicational means grew only by 28% and storage capacity by 23% in the above mentioned period.
- If we divide it by capita, then calculation capacity doubled in a year and a half, telecommunication capacity in two years ten months, while information storage capacity of the world doubled in forty months between 1986 and 2007.⁶⁵

This unit discusses the development of the knowledge based economy in some aspects of business. We will have an overview of the concept of knowledge, based on the characteristics of several criteria. The organizational learning process is based on SECI model. The three steps of integration of knowledge management into the company's strategy and knowledge capital structure will be discussed. In the second part of the unit we will talk about the evolution of information systems in companies, and organizational role of modern integrated systems and the individual components.

⁶⁵ HILBERT, MARTIN – LÓPEZ, PRISCILA: The World's Technological Capacity to Store, Communicate, and Compute Information, In: Science, Vol. 332. 2011.apr. 1., Washington DC



37. Figure: The role of corporate information and resources

8.2.1 Definition and characteristics of knowledge

In the last third of the XX. century in developed economies information started to have more and more important role, it became a resource. Because of the information boom nowadays societies use and deal with a big amount of information. To access, use, evaluate there is an increasingly sophisticated toolbar. 95 percent of the available knowledge existing today, did not exist 50 years ago. There are several estimates published that in the past five years, humanity has created three times more information than during the entire previous history. The importance of knowledge is growing in the economic sector, instead of traditional resources this is becoming a major source of competitive advantage. The following figures also support those trends.

- In 1950, the US manufacturing industry generated surplus. 80% was raw materials and food processing and only 20% knowledge. In 1995, the figure turned around 30-70%.
- The proportion of graduates of higher education in the US. In 1980s was 35% in 1993 went to 56% in the 15-24 age group.
- Between 1975 and 1995, the OECD countries amounts of R&D spending grew three times faster than manufacturing
- During this time, the US increased by 48% the number of patent quotations, in the knowledge-intensive sector by 182%.

Nowadays, we are witnessing an important change in attitude, which takes place in information technology, theory management and corporate governance. In the earlier development stage miracles were expected from technological factor, from information technology. Nowadays, human factor, the role of human knowledge "takes over its place". After the US and Japanese development results, it started to spread widely in the world.

In the 21st century advanced knowledge and innovation systems have become defining elements of economic development including creation of knowledge, development, utilization and institutional structures and processes. Generally there is no definition for knowledge available, however, many definitions could be used preferably. For example:

- ☞ **Knowledge is people's ability to use information to solve complex problems and adapt to change.**⁶⁶
- ☞ **Knowledge is demarcated, ever-changing mix of contextual information, experiences, values, and expertise, which provides a framework for a new experience, information evaluation and acquisition, in the minds of those where knowledge is generated and utilized. Companies keep it not only in documents and stock lists, but as part of the organizational routines, proceedings, practical activities and also embedded in norms**⁶⁷

Knowledge features:

A. **In terms of transferability:** knowledge generally can be divided into two main groups: tacit and explicit knowledge.

- Tacit knowledge: connected to person and this knowledge may not or limited be transferred:
 - it is created as a result of learning, socialization and experiential processes.
 - it is difficult or no way to communicate (or handed over).
 - it is applied without reflection mechanisms.
 - it can be divided in mental (intellectual) habits and into technical components (skills, patterns of action).

⁶⁶ CHIKÁN, ATTILA: Business Economy, AULA Kiadó, Budapest, 2008., 328. p.

⁶⁷ HARNOS, ZSOLT – HERDON MIKLÓS (szerk.): Information Systems, Debreceni Egyetem Agrár- és Műszaki Tudományok Centruma Agrárgazdasági és Vidékfejlesztési Kar, 2007. 62.p.
http://miau.gau.hu/avir/intranet/debrecen_hallgatoi/tananyagok/jegyzet/26- Informacios_rendszerek.pdf

- Explicit knowledge: it can be described, directly transferable knowledge.
 - it can be recorded in docs, databases
 - it is easy to communicate

B. **Ability to Accumulate:** Explicit knowledge accumulation is relatively easy to implement, by databases, document libraries and computer memories. Tacit knowledge is accumulated in each individual. Concrete cooperation, transfer of experience is needed to take over.

- Accumulation of knowledge is realized through the process of learning and experience, knowledge management vitalization achieved through the process of - interconnected - function of these two.

C. **According appropriability:**

When applying knowledge in business it is important to be able to realize (gain) economic value, grant benefits from its use for his own. Knowledge is accumulated in individuals, and has specific characteristics which assure that (unlike other resources) it will not be lost when used, (even enriched by experience) it remains with the individual. However, the company cannot monopolize the knowledge of the individual, except documented forms of explicit knowledge eg. patents, while with tacit knowledge it is theoretically impossible. Knowledge management has an important task, to use personal knowledge capital held by individuals (employees) to serve corporate objectives the greatest proportion. It basically depends on the success of human resource management motivation and organizational activities of the company.

8.2.2 Individual and organizational knowledge

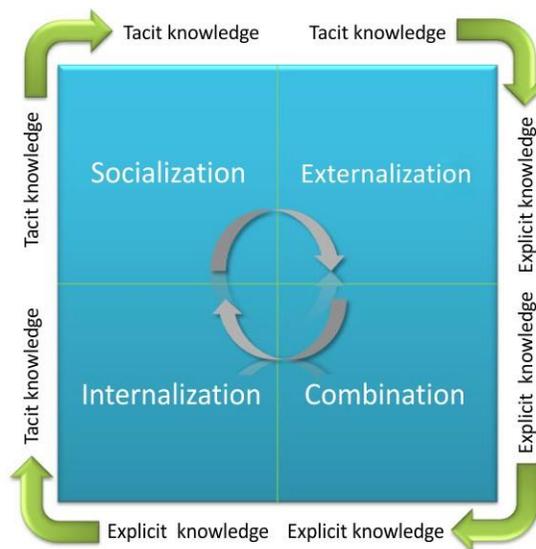
Organizations learn through their history which they encode into their behavior affecting routines. These routines are independent of individuals, they may survive even if a large number of individuals leave the organization. This way organizational knowledge is more than aggregation of individual knowledge, knowledge can appear in groups, on individual level, organizational and even inter-organizational level.

Components of organizational knowledge are individual knowledge and the relationship system of individuals. According to the growth of organizational knowledge, organizational learning can happen in three ways:

- individual's learning;
- more clever individuals enter the organization;

- higher level of organization of knowledge transfer between individuals.

An important condition for successful company operation is that the members have specialized knowledge for the required operation, and they can use them in an effective way. The goal is to effectively integrate the different knowledges. (There is no sense that each member learns what the other already knows.) The process of corporate learning is shown in Nonaka conversion matrix (SECI-model) (figure 28.) which describes the certain types of knowledge coordination with each other and the cases of transfer.



38. Figure: The SECI model⁶⁸

The elements of SECI model:

1. During **socialization** tacit knowledge will be shared: a man gives hidden knowledge to another, from tacit knowledge tacit knowledge is produced in the other man's head.

- Passing of tacit knowledge is not via language, rather observation, imitation and practice is the way to acquire it.

⁶⁸ Forrás: NONAKA IKUJIRO – HIROTAKE, TAKEUCHI (1995): The Knowledge-Creating Company. How Japanese Companies Create the Dynamics of Innovation, Oxford University Press, New York, USA, 1995., 71. o.

2. During **externalization** codification, articulation of hidden knowledge takes place and as a result of tacit knowledge, codified explicit knowledge arises.

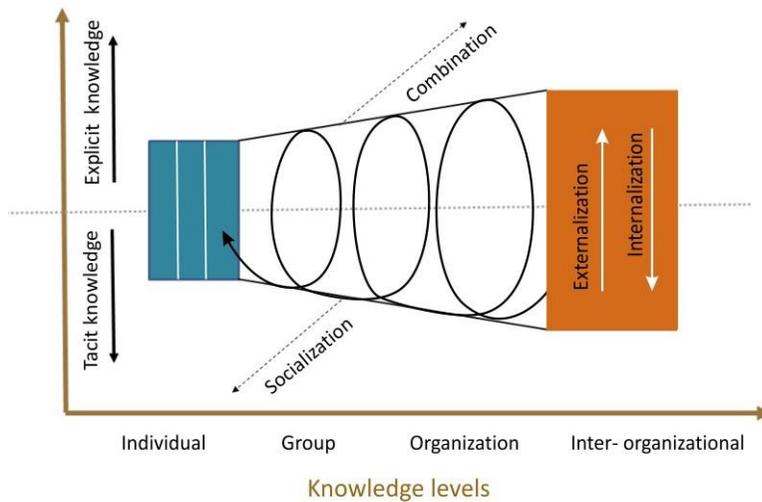
- ☐ This process cannot be identified totally with wording or writing. The search for analogies and metaphors application play an important role in the expression of tacit knowledge. (eg. a description of the organization of conferences, a description of a check-list).

3. **Combination** of existing concepts means systematization of various explicit elements of knowledge. The aggregation of information, grouping, placing in a new context, according to new aspects of the system can lead to generation of new knowledge.

- ☐ This process takes place within the framework of formal education. (sorting, categorizing, editing, etc.).

4. **Internalization** is the process of understanding, conversion of tacit knowledge to explicit knowledge, which is close to the traditional and learning by doing types of learning processes. (ie. a new worker starts to work, he will internalize his theoretical knowledge with practical)

Organizational learning is resulted from helical repetition of integration processes described above. The starting point of the spiral is man itself (he has accumulated tacit knowledge) the first step is cooperation of people, the process of socialization. Through their communication and systematization of knowledge and then implementation in practice they get back to tacit knowledge on a higher organizational level. In this process, two things happen: First, with expanded use of knowledge is constantly changing the organization (This leads to the necessity of changing management). On the other hand knowledge capital is created and enriched, which is an integral part of the company's resources.



39. Figure: The process of organizational learning⁶⁹

- The task of knowledge management is essentially shaping and implementation of the organizational framework and management of these processes.

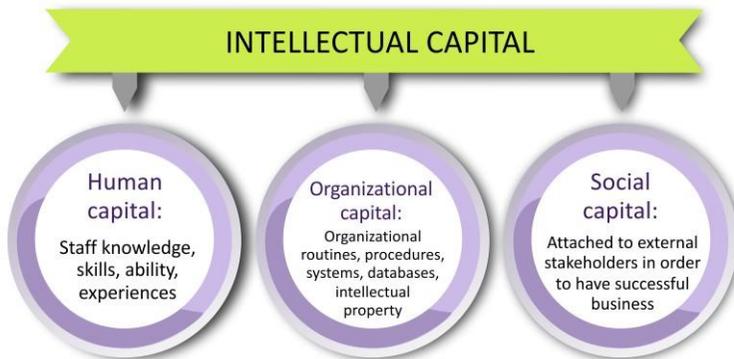
8.2.3 Knowledge Management and Strategy

Knowledge management as a corporate function is responsible for the integration of the components of intellectual capital and interconnection with other functional areas of business operations. To perform this function larger companies rarely create an independent organizational unit, implementation of the function is usually incorporated into other functional areas of management. Human resource management plays a key role, individuals are the main sources of knowledge.

- ☞ **Knowledge management is about to ensure continuous availability of intellectual capital in order to achieve the basic objectives of the company.**

The components of intellectual capital

⁶⁹ Source: NONAKA IKUJIRO – HIROTAKA, TAKEUCHI (1995): The Knowledge-Creating Company. How Japanese Companies Create the Dynamics of Innovation, Oxford University Press, New York, USA, 1995., 73. p.



40. Figure: The components of intellectual capital⁷⁰

Knowledge management can be integrated into enterprise strategy in 3 steps. First, linking of organizational knowledge and corporate strategy must be implemented which as 3 levels. The next step is to answer the main questions of knowledge management strategy. The last (third) step is development of the strategy and its implementation which may result in increased intellectual capital of the company.

1. Knowledge levels

The creation of intellectual capital, organizing corporate strategy is the starting point according to Zack. Organizations should prepare themselves a frame, which helps the organization to explicitly link competitive position and knowledge management strategy, thereby contribute to acquiring competitive advantage. Each organization is able to come up with a new method of connection between knowledge and strategy to get from the basics, through the advanced, up to the organizational development by distinguishing three types of knowledge:

- Base ("core") Knowledge: In a particular economic sector the competing companies all have this knowledge (eg capable of producing a car, which can be given five-year warranty.).
- Advanced knowledge: a competitive advantage for the company (because they know more than the competition or because they

⁷⁰ Source: RICARDIS : Reporting Intellectual Capital to Augment Research, Development and Innovation in SMEs, Report to the Commission of the High Level Expert Group on RICARDIS, June 2006 http://ec.europa.eu/invest-in-research/pdf/download_en/2006-2977_web1.pdf 17.p.

use different skills). For example, a better knowledge of potential buyers, so they can offer credit terms more favorable than others on buying cars.

- Innovative knowledge: the company may become a market leader with it. The reason is: innovation activity.⁷¹

2. The main issues of knowledge management strategy:

- Which attributions does the organization consider of strategic importance?
- Components of knowledge of which processes or products result in the best added value?
- How can knowledge competitive creation power of management's strategy be represented?
- How does the chosen strategy of the organization's fit in the mission, the short or long term objectives of the company?

The responses could be different because of the market position, industry position and the existing resources. Fields of knowledge could be used in all industries and organizations: the key area of knowledge, basic knowledge, promising field of knowledge and knowledge of an area which is not significant. Key knowledge can be characterized by having high-growth and high-value-added potential. These areas of knowledge distinguish the company from its competitors, and have the greatest impact on the organization's lives. Starting from this information, above mentioned strategies should be adapted to the organization. Three main contributions of knowledge management to the company's success:

- The company organizes in an appropriate structure the unorganized, opaque mass of information, then changes this subset into organized knowledge
- Embedding external, well structured information can play a proactive role
- Well structured internal information makes it possible to the company to see existing and required individual and organizational knowledge elements and the points where changes are needed. This way opportunity to internal flexibility and change management could be created.

3. Knowledge Management implementation, knowledge capital

⁷¹ Source: ZACK, M.H.(1999): Developing a Knowledge Strategy, California Management Review, Vol. 41., No.3., Spring, p. 125-145.
<http://web.cba.neu.edu/~mzack/articles/kstrat/kstrat.htm>

Essentially this means the **creation, management and use** of corporate knowledge capital.

- The creation of knowledge capital is based on the data - information, personal knowledge - organizational knowledge and linking the elements and inserting the established information system and decision-making in the company's organizational structure and culture.
- Administering knowledge capital is provided by the company's human resources management. The necessary tasks (staff selection, training, education) are usually organizationally assigned to this function. The senior management helps to ensure the integration effectively from individual knowledge into organizational knowledge. Its tool is to create formal and informal corporate structure and culture design and operation.
- The use of knowledge capital in the company's operation is carried out by the relevant functional departments. Knowledge capital does not decrease, but rather increase. Thus - in case of properly implemented systems - a very important positive feedback prevails as indicated in point A into the direction of resource- establishment.

Successful implementation of knowledge management into strategy can lead to the increase of company's intellectual capital and the company's value growth. It is not unusual that the value of the company is in higher proportion of intellectual capital, and not financial, and physical capital (machines, buildings, furniture). Therefore the use of intellectual values is becoming increasingly important parts of value creating processes.

The structure of knowledge capital

The elementary components of knowledge capital structure is data.

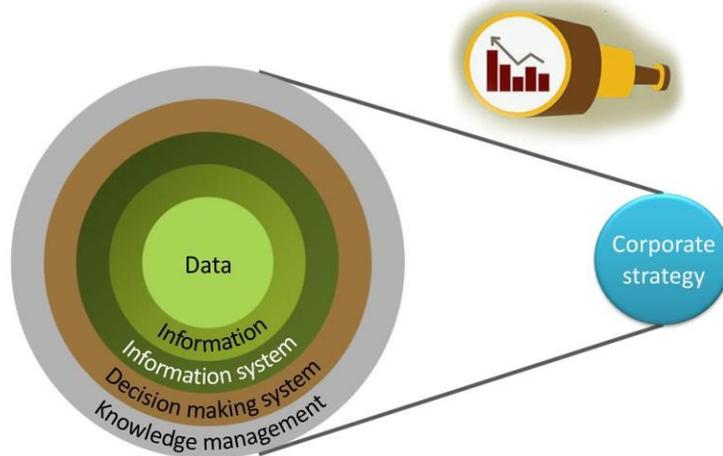
 **Data is detected, but not defined symbol, facts, measurements, which refer to a situation at a particular time. By creating a relationship between more data we can move to a higher conceptual level.**⁷²

⁷² SÁNTÁNÉ, TÓTH EDIT: Knowledgebased technology, expert systems. 12. chapter. In: Futó Iván (szerk.): Artificial Intelligence. Budapest, Aula, 1999. 986 p.

In other words: Data is a "set of objective facts related to events." In order to understand it quickly we should primarily consider statistical data.⁷³

Characteristics of data:

- There are many data created in every institution, company. Data logging, processing, transmission, requires wide variety and extremely sophisticated assets.
- Modern organizations always keep data in technological systems. Defined data structures are often organized based on a traditional data model in order to standardize, sort, data processes and statistical records.
- Data changes into information if it gets some meaning. Some kind of judgment can be formed, which will trigger an action for specific purposes.



41. Figure: Knowledge Capital Structure⁷⁴

8.2.4 Information and enterprise information system

Data changes into information if it gets some meaning. Some kind of judgment can be formed, which will trigger an action for specific purposes.

⁷³ PAKUCS JÁNOS – PAPANEK GÁBOR: Innovation Management Guide, Budapest, 2006. 115. p.

http://www.innovacio.hu/tanulmanyok_pdf/innovacio_menedzsment_kezikonyv.pdf

⁷⁴ Source: CHIKÁN, ATTILA: Business Economy, AULA Kiadó, Budapest, 2008. 339.p.

Characteristics of Information:

- Data is "objective", information is "subjective" it means for everyone something different, without human it has no sense.
- From business economics perspective information is nothing more than "important knowledge to function the company " Thus, it should be seen as a resource.
- The role of information in all sectors of society is growing. In education, administration, research and development, entertainment, last but not least, in economic life.
- Information is a quite important element of corporate resources. It has a place in planning and decision making models, as well as in performance and profitability survey. It is integrated into product design and marketing methods.

Why has information, knowledge become a critical resource, a success factor? What is the reason that the society we live in, is more often called information or knowledge society? All of this is connected to many factors (globalization, competition, IKT, development, digitalization, etc. / but the most important is that information's role, acceptance, and use is one of the key pillars of today's modern society. Information and knowledge is important, valued resource, which can be accessed through paid or unpaid and well developed channels. The society more and more takes this opportunity.

 **Information system: the collection, processing, storage, performing services, activities, and persons and all devices, which are connected to internal operations and transactions between the company and its environment. It has 4 components:**

1. **People** who fulfil different functions in the organization corresponding to the division of labour and create and use information;
2. **Organizational structure**, which has been established for information management, which provides a framework for the relationship between humans and other elements of the information system;
3. **Operating system**, information technology, which is the collection of hardware and software;
4. **Business processes** that we want to arrange, control with the help of information system.

Information and organizational role

Information and the exchange of information plays an important role at various corporate hierarchy levels. We speak about vertical flow of information between the levels of management. Between the functional units of the company - on the same management level - information flows horizontally.



42. Figure: The hierarchical levels after management decision-making and activity domains⁷⁵

Connection between necessary information for decisions and organizational role has two approaches: Organizational hierarchy and functional work share.

Different level and function managers have the main role. Leader function and decision making function is almost the same:

- Owners and senior corporate managers make strategic decisions: These are the main directions of the operation of the company's operations, long-term decisions on objectives and assets connected to one another .
- Mid-level management is responsible for management decisions: They are strategy decisions for he concrete regulation of the company.

⁷⁵ Source: CHIKÁN, ATTILA: Business Economy, AULA Kiadó, Budapest, 2008. 350.p. alapján saját szerkesztés

- Lower-level management has responsibility to make operational decisions: Decisions on the implementation of specific activities.

Information needs of management decisions

Information needs of some management levels are different. This difference may be characterized by several important features:

Main characteristics of information	Hierarchy levels	
	OPERATIVE	STRATEGY
Source	Internal	External
Content	Narrow	Wide
Aggregation	Detailed	Comprehensive
Nature	Quantitative	Qualitative
Accuracy	Accurate	Not accurate
Up to date	Total	Partial
Use	Often	Casual

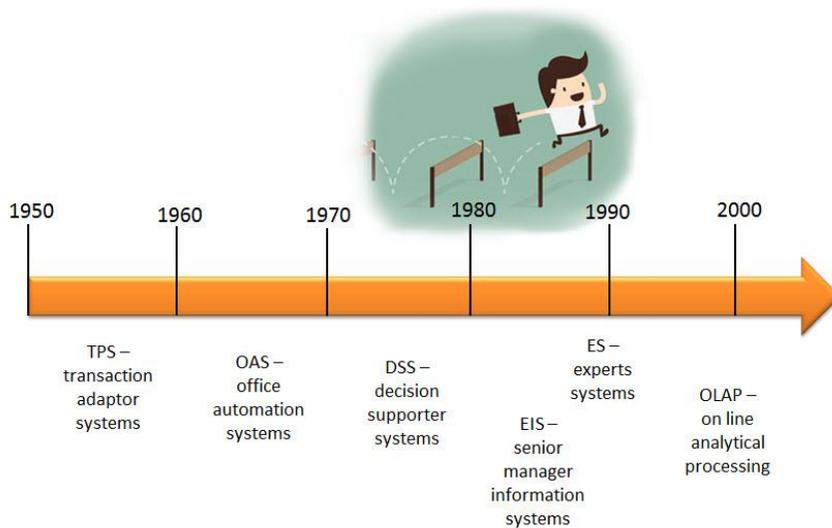
43. Figure: The information needs of management decisions⁷⁶

These properties are continuously changing from operational level to strategic level. The actual influence of stakeholders in corporate operations and power relations is determined in the information system, their role is largely determined. They often operate (plus or minus) from what would be their formal organizational role.

Development of Information systems

The formation and evolution of enterprise information systems can be traced back about 60-70 years. The appearance and performance improvement played a major role in the spread of electronic computers. The emergence and spread of certain corporate information systems is shown below:

⁷⁶ Source: CHIKÁN, ATTILA: Business Economy, AULA Kiadó, Budapest, 2008. 351.p.



44. Figure: Information systems development stages⁷⁷

The development of enterprise information systems can be categorized as follows:

1. **Island Systems:** These systems worked separated functionally and worked on management levels. The main problem is caused by the independent nature of the system:

- The same information must be entered into each system separately
- There is a risk of inconsistency (incorrect, inconsistent state) formation
- Managing changes is very difficult
- Linking the systems is a huge effort, and requires a lots of time and money

Elements:

TPS – Transaction Processing System: primarily responsible for the data from the company's core economy (financial and production) processes of storing, aggregating.

⁷⁷ Source: HARNOS ZSOLT – HERDON MIKLÓS (szerk.): Information systems, Debreceni Egyetem Agrár- és Műszaki Tudományok Centruma Agrárgazdasági és Vidékfejlesztési Kar, 2007. 116. p.
http://miau.gau.hu/avir/intranet/debrecen_hallgatoi/tananyagok/jegyzet/26- Informacios_rendszerek.pdf

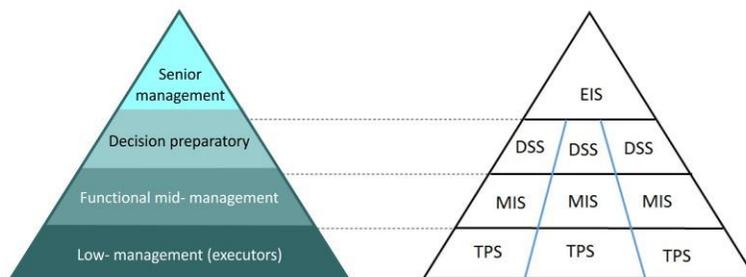
MIS – Management Information System: a system for the management of corporate activities, it serves data, reports, summaries, built-in system analysis and decision-making models / functional area of a comprehensive reports /.

OAS – Office Automation System: its task is managing and automating corporate functions in electronic form (eg. email, vouchering, communications).

DSS – Decision Support System: interactive systems that support both individual and group decision when the problem is structured in part or not at all. The most important tasks: modeling, sensitivity analysis, the search target value, risk analysis, graphical analysis. Two main directions: operational and strategic decision support.

ES – Expert System: based on specific information needs of senior managers. Specific communication technology and user-friendly analytical assets are used. (large support, customized applications, mainly for historical analysis function). Topics:

- summary tables about financial situation of the company,
- signaling role of data, critical values,
- the company's most recent problems and their components
- Update, analysis of the enterprise value chain,
- Corporate performance indicators (organizational units) connected to the main responsible person
- Detection and comprehensive analysis of market positions.



45. Figure: A typical island-style corporate information system in the second half of the 80s⁷⁸

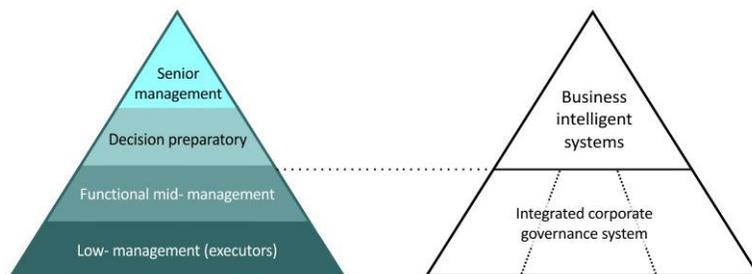
⁷⁸ Source: GÁBOR, ANDRÁS (szerk.): Selected topics in the topic of information management, BKÁE, Információrendszerek Tanszék, 2000., 184.p.
<http://mek.oszk.hu/01200/01254/>

2. Integrated systems

Development was a logical step. The development of unified services incorporate discrete, complex, integrated systems. In parallel with the appearance of the development needs IT infrastructure reached the level which favored the creation of new, complete systems:

- Cheap personal computers
- More powerful machines
- Development of Networks

Complex systems created in the 1990s can be basically divided into two main parts:



46. Figure: Business intelligence and integrated corporate governance system⁷⁹

Business Intelligence: Applications and technologies which ensure access to necessary data, proper storage of information, and versatile analysis capabilities to support decision making. Business Intelligence solutions thus include data storage, real-time query, analysis, forecasting, and data mining methods in modern forms.

DW – Data Warehouse: Data warehouse itself is a complex information system whose core is high performance data storage. Part of this is a controlled and scheduled loading (charging) system and the availability to analyze data and its enabling query analyzer systems. Its fundamental objective is analysis of the stored information. Data is stored separately from the source transaction systems in a database structure that is optimized for query aspects. It contains corporate-level overall information, by linking different data areas including integrated data, time-series format.

⁷⁹ Source: HERDON, MIKLÓS: Management Information Systems, Debreceni Egyetem Agrár- és Műszaki Tudományok Centruma Agrárgazdasági és Vidékfejlesztési Kar 2004. 9.p. http://oszkdk.oszk.hu/storage/00/00/33/13/dd/1/C3_tananyag.pdf

OLAP- On-Line Analytical Processing

See at integrated management system.

DM- Data Mining: During data mining from data warehouse or from other information databases we obtain data that has a significant informative content or complex, usually hidden relationships can be gained. These relationships can help to make important business decisions.

- **Integrated Business Management System:** a united information system that implements all the company's business transactions

Characteristics:

- Generally data and process integration across the whole company is implemented.
- Ability to manage all data in a wide range of sectors (eg. the industrial manufacturing, commercial companies, banks, insurance companies, media, healthcare, automotive, oil industry, commerce, etc.). and all data from multi-national companies, and they do all data processing .
- These systems process increasingly wide range of business transactions, plan business resources, supply various management levels with necessary information about their decisions and support adaption of these decisions.
- Vertical corporate division of labor can be divided to management information and decision support functions, as well as transaction processing functions
- Horizontal division of labour: The management information systems of the company follow the company's organizational structure. for example: division to functional modules, when in these systems financial accounting, controlling, fixed-asset management, production management, inventory management, sales, human resource management and other modules are distinguished.

The company's management information systems, have two tasks:

- **On-line Transaction Processing OLTP:** quickly and efficiently processes a large number of business transactions generated by companies.
- **On-line Analytical Processing - OLAP:** provides company leaders with information to make decisions. Allows certain services for example modelling financial problems, and thus analysis different versions of decisions is possible.

The criteria of integrity:

- In an integrated information system each step of the process passes the information to the next steps in the way, that meanwhile the means do not change (eg. : not save the data and then loaded into another computer and / or the system again).
- No multiple data entry (eg.: warehouse inventory data is not printed out on paper and is not written back to another computer) no need for it.
- In an integrated system functions and activities cannot be mixed, and not duplicated, but they have a close connection (goods taking into inventory system, but when the bill has been received the system must be able to recognize it. Wage figures can be calculated in the payroll system. The work hours, if it is in the system do not have to be checked again, and so on).

Possible components

ERP – Enterprise Resource Planning

- It carries out integrated planning of production and related resources
- It may include managerial relationships
- Full support for operational level
- Modular structure

CRM – Customer Relationship Management:

- It is built on strategies, software, and other functional web-based tools that help the company with customer relations organizations, and management
- Its aim is to enable the company to better understand, what means value for customers. So it enhances the efficiency of corporate communications with customers, by increasing customer satisfaction.
- CRM collects, analyzes and disseminates relevant customer data helping customers and within company interaction everyone. Appropriate distribution of information supports the organization to meet customer needs better in terms of products and services.

SRM - Supply Relationship Management

- The integration of supplier processes greatly enhances the company to run a smooth supply of materials, to detect and reduce the cost of errors.

- Its main tasks are selecting suppliers, purchasing and carrying out activities related to the received materials and goods.

SCM – Supply Chain Management

- They do coordination of IT background to ensure it the supplier-customer related companies. They facilitate communication and cooperation between the partners in production, design and implementation of logistics activities.

- EPM – Enterprise Performance Management

- Corporate Performance evaluation component, which facilitates the implementation of strategy, there is also individual and group performance assessment.

- KM - knowledge management

- Generic for corporate knowledge accumulation and distribution of assets.

8.3 SUMMARY AND QUESTIONS

8.3.1 8.3.1 Overview

Nowadays, knowledge application and accumulation are assets to increase companies' efficiency, it is a resource that can be increased almost indefinitely. Knowledge management is one of the latest business management concepts, integration into organizations, in many companies are currently in progress. The main task together with human resources management is that knowledge of individual members of the organization can be used as efficiently as possible to get organizational knowledge and capital. In addition, a further task is to use the knowledge acquired elsewhere in their purpose more effectively. Knowledge capital value in several companies of the industry has greater value than the value of tangible capital. Ways of knowledge capital increase could be the following: organization of individual learning, more powerful individuals entering the organization and organization of the individuals knowledge transfer on a higher level. Information, as a base of knowledge is an important corporate resource. Data collection, conversion, organization, storage and delivery to decision makers is performed by the information system. The radical development of IT is transforming the world of business.

8.3.2 Self-check Questions

Explain the concept of knowledge and its features!

Describe the organizational learning process based on SECI model!

Explain the concept of knowledge management, distinguish the components of intellectual capital!

Describe the steps for knowledge management integration into corporate strategy!

Distinguish the components of the knowledge capital structure!

Explain the concept of information, prove why it has become today a critical resource for companies!

Explain the concept of corporate information systems, distinguish its elements!

Distinguish island systems from integrated information systems!

What is integrated business management system, and what are the main features?

Describe the possible components of the Integrated Management System!

8.3.3 Self-check Tests

1. The company is never allowed to expropriate individual's knowledge. FALSE
2. Combination means placement of existing concepts, explicit knowledge in a system. TRUE
3. Integrated business management systems spread in the 1970s, in corporate sector. FALSE
4. The DSS technology makes it possible, that the company's data appear organized, consolidated, and in clean time series, without overloading the IT infrastructure in order to make decisions. FALSE
5. OLTP function means quick, efficient process of the large number of business transactions generated by companies. TRUE
6. SCM systems ensure IT coordination background to related supplier-customer companies which promote communication and cooperation between the partners in production, and in planning and implementation of logistics. TRUE
7. In integrated ERP system functions and activities cannot be mixed, and cannot be duplicated but they are closely related. TRUE

9. VALUE CREATION MANAGEMENT: FEATURES OF PRODUCTION, SERVICE PROCESSES. LOGISTICS STRUCTURE OF COMPANY.

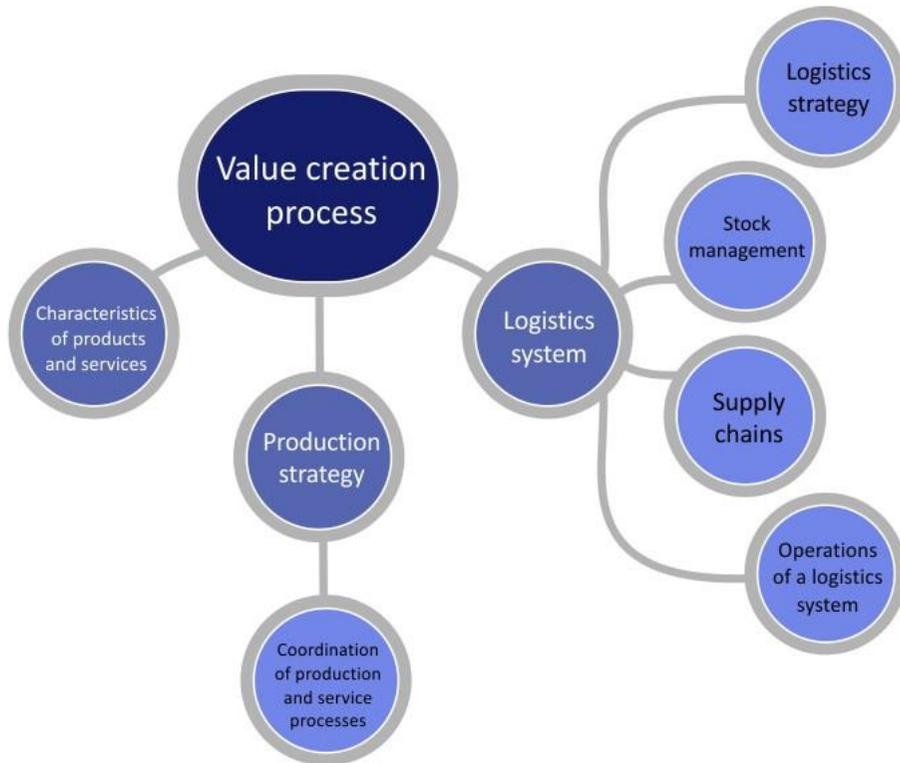
9.1 GOALS AND COMPETENCIES

By the definition of microeconomics "company is a form of advanced business; it follows income goals, a developing system that transforms resources as inputs into output.⁸³ From the definition above can be read the role of company in economy that is by combining resources it performs a transformation (conversion) process, during this an output is generated which represents value for the consumer. This transformation is called by the company a value creation process. In this lesson we intend to investigate the characteristics of logistical production series. Students should know the components of value creation process, be able to group production processes in several ways, be able to determine the elements of manufacturing strategy, and their relation to each other and to corporate functions. They should be clear with technology life cycle concept and familiar with its components. They are expected to be familiar with computer integrated production, MRP - Manufacturing Resource Planning concept, and elements of the system. Students should be able to distinguish between stages of logistics development, components of function, and components of strategy. They must be informed about the operation of logistics system.

9.2 UNIT

The unit looks at the concept, role and value-added components of the processes. In this framework we are going to characterize production and logistics processes. First, types of production and services will be performed in different aspects then we will examine the components of production strategy. Technological life cycle stages are related to the nature of production system and production volume. At organization of production methods we discuss in details the elements of computer integrated production and MRP system components. Japanese JIT - Just in Time - principle's advantages, disadvantages will be presented.

In smooth running of the business processes the company's logistics function plays an important role. In the following, we group logistics system processes, and determine the most important tasks of logistics strategy. In connection with the operation of logistics we review inventory management system and management of financial processes.

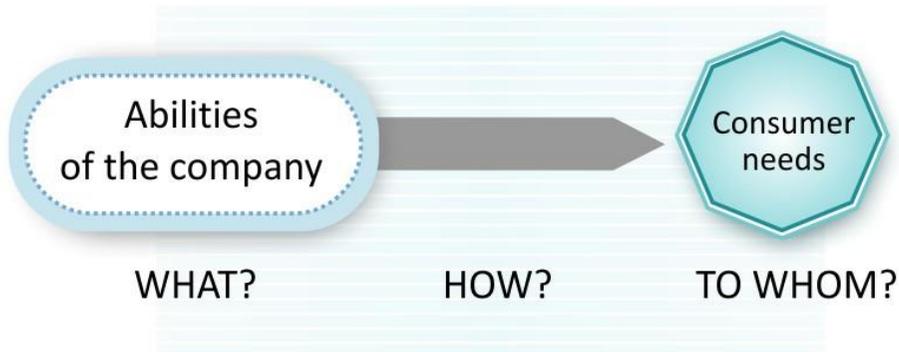


47. Figur: Value-creating processes of the company

9.2.1 Value Creation Process and Components

One of the basic organizational units of modern market economy is company (the organizational framework of a business) constructed to satisfy customer needs while achieving profit. In order to satisfy these the company should be able to generate such goods (products and services) that are of valuable to consumers.

- ☞ **Value creation realizes the transformation of resources into consumer value (transformation).**



48. Figure: Components of Value Creation Processes⁸⁰

Consumer demand is a demand that players of the economy will not satisfy with work within their organization not even through community institutions. Consumer demand will appear as an effective demand for goods. This usually has four dimensions:

1. **Value of use:** Attributions that make the product be able to satisfy needs. (eg, colour, taste, shape, weight, etc.).
2. **Value of place:** The product is available at the right place for the consumer. (eg. online trade value is able to expand place)
3. **Value of time:** The product is available when there is need for it.
4. **Value of ownership:** The owner has the right over the product.

Value-creating process consists of two components: production and service

 **Production: usage of a portion of available resources for the purpose to create new goods.**

Production processes can be grouped in several ways:

A. **According to the nature of the product:**

- **Standard product:** usually has a homogeneous material structure eg. brick, butter, cloth, beer, bread.
- **Complex product:** typically has a heterogeneous material structure, for example. building, car, phone, etc

⁸⁰ Source: CHIKÁN, ATTILA – DEMETER, KRISZTINA: The management of value creation AULA Kiadó, 2001., 5.p.

B. According to the production system:

1. Flow Shop (process-based production) During manufacture the product goes through a product-related production chain.

Features:

- narrow range of products, a significant volume of production,
- low-skilled workers (manual labour)
- high initial capital commitment (relatively expensive equipment)
- low working capital required,
- easy to control quality, consistent product quality,
- transparent inventory management,
- low flexibility of production,
- low unit cost, fast delivery.

Special subtype of it is **Continuous Processing**: production does not occur in discrete product units. For example: chemical, petroleum, food / beer, milk, sugar / production

2. Job shop (workshop production-based) equipment or people performing the same operations are located 1-1 workshop, the product in terms of the process flows relevant way between the workshops.

Features: It is characterized by the opposite features of the flow-shop production system.

Special subtypes: Basically, there are three subtypes, the first type constitutes transition between job shop and flow shop.

- *Batch production (mass production):* After manufacturing several identical products (small or large series) the machine is switched over to producing products with different characteristics.
- *Unique production:* production of each product is followed by adaptation of the machines (serial number 1)
- *Project System:* Not flow of products is going on the machines, but production equipment, work force is taken to the place of production. For example: construction

C. According to production lines: The classification is based on the nature of the inputs and outputs of production, that is what is the nature of converted inputs. Groups:

- Agriculture (as well as forest, fish, wildlife management)
- extractive industry (mining, oil extraction, etc)

- processing industry (inputs are provided typically by extractive industry)
- Food industry (inputs are typically provided by agriculture)
- construction industry

 **Services: Use of resources in non-productive way, activities that satisfy consumer needs.**

Main characteristics:

- The nature of new products is that innumerating its physical quantities is not possible.
- Quantity is measured rather by durability, duration and intensity of activity, than by some features of output
- Typing: Service industries / according to Browning - Singelmann /:
- distribution services (transport, storage, telecommunication, wholesale and retail)
- producer services (finance, insurance, real estate, engineering, accounting, legal, etc.).
- social services (health, education, welfare, religious, postal, experts, social, etc.).
- personal services (household, finance, hospitality, repair, cleaning, hairdressing and beauty, entertainment, recreation, etc.).
- Classifications based on different criteria:

A. by tangibility:

- **Tangible** : eg. delivery, hair salons, car repair, etc ...
- **Non- tangible** :eg. insurance, consulting, education, etc ...

B. Production Process:

We distinguish service after the process of manufacturing:

- Device-oriented services - the main source of supply is equipment: car washes, movie theaters, flight-control).
- People-oriented services, where the essence of service is represented by interaction between people(catering, consultancy etc).

Service cannot be stocked, and thus opportunity of usage is fleeting.

C. marketable and non-marketable services

- **Marketable service** is when addressed is known so remuneration for the service can be requested.
- **Non-marketable or public service** its essential feature is that the range of use is unspecified.

D. **Relation to production as:** according to the relations of production there are the following differences:

- **In overall sense it means** all production activities are servicee for consumers
- **In narrow sense** of production services can be related too, which are essential to fulfill the needs of consumers (marketing, legal and advisory activities, transportation)
- **Basic services are different from the ones** in the previous paragraph that there the source of consumer utility is a product, here consumer demand is directed specifically to the service.

E. **Relationship according to consumption:** Services are realized over time

- **services continuously implemented** (eg. Insurance, legal protection)
- **not continuous, but repetitive** (eg. Maintenance) and
- **single**, direct services for final use (eg. Restaurant).

F. **According to transportability:** services are

- **transportable**, can be sold for example. bank operations or information services
- **not transportable, can only be used in at a specific location** where direct connection is established between the consumer and the producer for example. expert service, beauty.

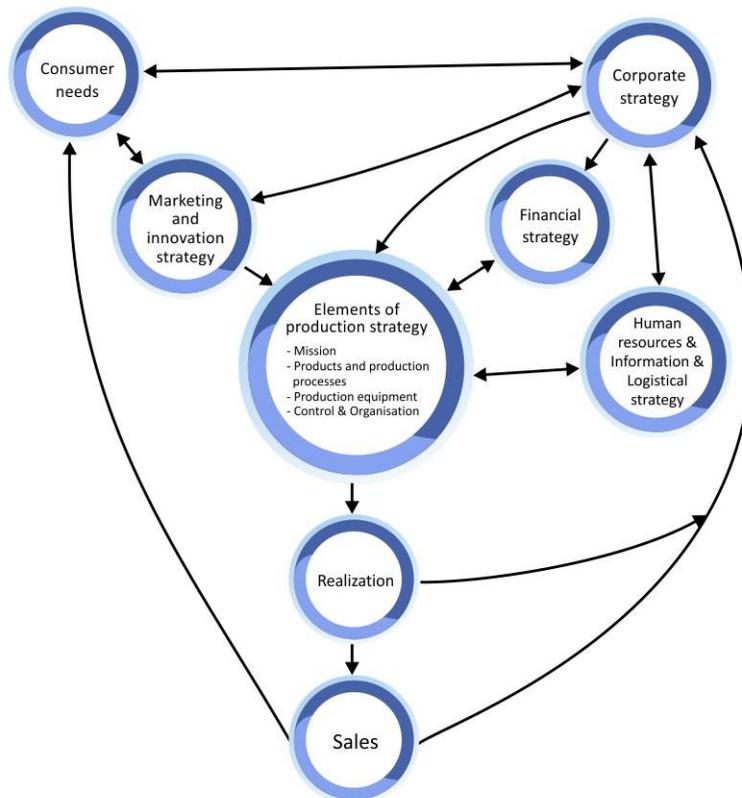
9.2.2 Production strategy

Production, as corporate function, only in the past 30-35 years has had strategic importance, both in business and in the literature. One of the main reasons is that in the 1980s marketing orientation has strengthened due to increasingly diversifying customer needs. Thanks to technology, information technology development companies can move more easily across national borders, they sell in foreign markets, work with foreign suppliers and can become multinational companies in a globalizing world. Expanding opportunities and increasingly complex, more expensive, more difficult and not easily replaceable technology, use of labor requires long-term thinking. A few decades ago purely executive role of production function could not be missed out of the integrated strategic approach. Figure 39 shows one possible result of placing the system in production strategy and its elements.

The factors of production strategy

Production strategy is originating from all-company strategy, directly from corporate mission. Closely associated with marketing and innovation processes it should be defined, that the company what and how intends to produce. To answer the problem above three important questions must be answered:

1. What are the main objectives of production management?
2. What kind of hardware elements, what composition, quantity, configuration is needed and where to place production?
3. What kind of production management and production organization principles should be applied?



49. Figure. Production Strategy Elements⁸¹

Main objectives

So that a company have success in a globalized world, competitive products and services must be provided to their customers. Competitiveness of a businesses is influenced by several factors. It should not be examined at a certain moment, but dynamically, taking into account the changes in trends. Competitiveness of businesses (corporate performance growth) is affected by production function through the following five factors:

- quality,
- cost
- reliability,
- flexibility,
- high standard of customer service.

⁸¹ Forrás: CHIKÁN, ATTILA: Business Economics, AULA Kiadó, Budapest, 2008., 418.p.

Since the mid 1970s, several programmes have been created to help production to contribute significantly to the increase of competitiveness of companies. A major part is managerial / organizational innovation, a lesser part is technological. The following programs seek to improve overall production system, though putting emphasis to different areas of corporate competence.

Material Management-oriented programs - they are based on material converter / assembly on nature of production, they increase the efficiency of management. Examples are JIT (just in time) production systems, requirement planning systems (MRP, Material Requirements Planning) OPT system for the management of bottlenecks.

Equipment-oriented programs - for automation, flexible manufacturing systems (FMS Flexible Manufacturing System) or computer-based integrated manufacturing (CIM, Computer Integrated Manufacturing) programs that build on greater effectiveness of the tools used in production.

Workforce-oriented programs - incentive schemes, group work and ones aspiring to "lean" systems in a sense of resource-saving are included here.

Quality-oriented systems - primarily total quality management or quality awards and quality management systems, for example. ISO 9000 family.

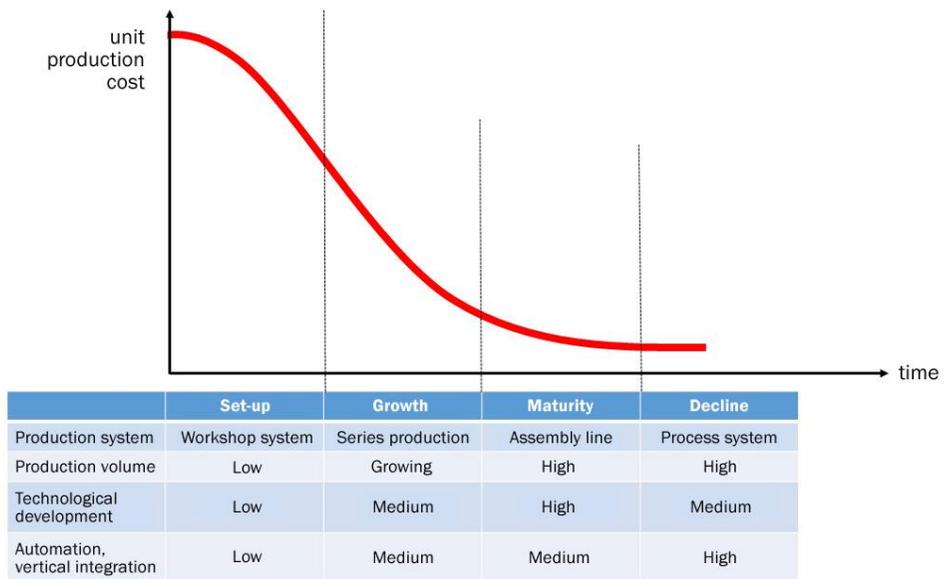
Time-oriented systems - are for decreasing total production time, downtime, and time for development and changeover

Consumer-oriented programs - development is based on consumer services, specifically to comply with the needs of consumers, connection of factory workers and consumers.

Process-based programs - eg. business process reengineering, value analysis processes, integration of functions.

Products and Technologies

The next step after objectives determination is definition of the products to manufacture and production processes. After the product life cycle analogy Hayes- Wheelwright (1984) introduced the concept of technology life cycle. Four consecutive life cycle stages have been distinguished in time, representing unit cost of product development. Characteristics: each phase is a typical kind of production system, different production volumes and rate of technological progress. As shown in each of the phases, life cycle begins with a fairly flexible, but less cost-effective, "free" production system. Over time it gets increasingly standardized, more efficient, but has high capital-requirements and develops into a less flexible manufacturing system..



50. Figure: Technological life cycles⁸²

One of the cornerstones of the company's profitable operations is to be able to produce as much as demanded by the market and manufacture scheduled products, provide the necessary **production capacity**.

In a general sense capacity is a limit of a company's performance, limit of some kind of resource (how much can a company produce with a resource segment).

The purpose of capacity calculating is actually the definition of productivity with maximizing the given opportunities. In the long-term companies should adapt capacity to the tasks planned (strategy) (eg. enlargement, scrapping, exchange). In short-term (annual plan level), the available machine capacity can make a limit to production tasks. Capacity could be calculated in natural units (pieces, to, hl, etc.) in calculated units, workload (standard hours) machine time (machine hours) and value (thousand HUF).

Production facilities in accounting sense, belong to the category of fixed assets, the two concepts are used as synonym.

Tangible assets appear in form of natural elements in company assets that serve operation in several production cycles.

⁸² Source: CHIKÁN, ATTILA: Business Economics, AULA Kiadó, Budapest, 2008., 421.p.

Characterization of tangibles:

- Their impacts are lasting and from several sides to the management of the company
- Payback is several years, so their technical quality determines the productivity of the company for long-term.
- Significant costs in connection with the **amortization (depreciation and amortization)**.

Amortization: Accounting for depreciation of fixed assets (physical and moral obsolescence) as expense.

Factors that fundamentally affect the composition of a company's tangible assets:

- company profile and strategy,
- the quality of corporate management,
- the size of the company,
- the installation location,
- the management of micro and macro environment, etc.

 **Establishment of fixed assets is investment,**

Investment is an asset to fulfil strategy. Investments have risks as organization capacity of the company is bound for long term, takes a lots of capital investment and it creates benefits slowly (many years), and unsure.

Maintenance of the assets is another strategy question since capacity is available under continuous maintenance. To insure the maintenance of the assets and tools of production is an important financial aspect, but there is no loss of production due to machines being out of order.

The management and organization of production and service processes

Management and organizational solutions of production and service processes are the answer how to integrate decisions on assets on the compositions of the products and capacities, decisions on localization, order of operations and timing. Available production organizational processes (principles) depend on the activity of the company (type of products), however, certain options are given. Besides traditional organizational principles which have two main groups (flow and job shop), from the end of the 20th century new radical changes have shown up in production organization. The main reason of it in developed countries is the differentiation and saturation of needs of consumers.

Therefore manufacturers need to develop more flexible production systems, typically with smaller production series, faster transition from one product to another. The development of microelectronics and computerization has enabled the spread of so called (Computer Integrated Manufacturing CIM). Computer-integrated production system does not mean a given system, but a manager philosophy, which is wider and later a full range of production is taken under the control of the computer.

☞ **Computer-integrated production (CIM) is a way of organizing production, where production design, production planning and control, materials handling and production are involved in a single computer controlled system**

Elements of the system:

- A. **CAD, Computer Aided Design:** interactive use of the computer to develop product plans and for drawings and data storage.
- B. **CAM, Computer Aided Manufacturing:** the use of computer to program equipment and facilities for the preparation, management and control of the product.
- C. **Production planning and management built into the company's sales plan** - taking into account the resource constraints - determines the amount and timing of the planned production.
- D. **Grouped technology** is a procedure based on the identical features of various products which allows production of certain phases together, on the same machine groups (the expediently placed manufacturing machines are also called production cells) to be produced together.
- E. **Automated material handling** allows the materials, parts to be moved without human touch, to place it into the warehouse, remove it and send it to the place of work.
- F. **Use of programmable robotics** to produce, to move material and to use manufacturing equipment.

CIM manager philosophy includes:

- **Quality Awareness:** quality should be incorporated into the product and into production, so external quality control is not necessary.
- Production must be seen as one process, not as a series of individual steps.
- Stock is not property element, but should be considered as withdrawn funds and should be reduced.
- Material and information flow should be handled together.

- Production organization directs process organization and not vice versa.
- Strive to simplify the processes.
- Decision making processes get to lower level in the corporate hierarchy, thus company management and organization system is greatly transformed.
- Integration of production process involves other corporate functions eg. marketing, innovation, logistics integration, so it makes necessary to create new corporate culture.

Production Planning and Management

After determining strategic tasks of production, according to the plans, the company develops the short and medium term plans, tasks associated with production. **Advanced manufacturing resource planning** (MRP - Material Resource Planning) appears embedded in corporate processes closely linked to other functions, for example. marketing, logistics, HR, and finance. The system has three main components:

1. **Integrated production planning**: responsible for determining the necessary resources and the needed amount of production.

- The starting point is demand management, which receives information from the marketing function. This area is a series of activities which collects information on demand, factors influencing demand and the company's delivery management obligations.
- Resource planning module defines available capacity (including financial information of the expected costs as well).
- Production control program is designed to establish the synchronization between the needs and opportunities. At this time they produce the planned volume production in scheduled time.

2. **Requirements Planning system (Material Requirement Planning)**: Its task is to assign the necessary material and component quantities set by the master scheduling. Thus the materials and capacity plan can be produced.

- This system highly relies on technical description of the standards and storage records data for each product.
- With use of this inventory, accumulation and unnecessary downtimes could be reduced.
- In advanced systems the power consumption capacity, labour, financial planning assets together occur integrated.

3. **Execution Module:** On the basis of material usage and capacity utilization plans it gives instructions to production sites (workshops, factories) and schedules to suppliers.

The "Just in time" principle - *Just-in-time*

Classical MRP systems are characterized by well defined constraints, some of them are:

- Customize fits poorly to economical quantities / internal optimization, which has impact towards standardization of products.
- The medium and long-term forecasts are even more uncertain. Frequent program corrections make programming of manufacture process even more disorganized .
- Adaptation of manufacture risks can lead almost everywhere to costly buffer stocks, which increases the risk of obsolescence.
- Because of the huge flow delay appears between the cycle time and process time and response to quality problems weaken.
- Increasing quality requirements lead to costly corrections and additional delays.

To fix the above mentioned problem area in Japan, along the development of Toyota "**Just in Time**" **process organization principle** was created which focuses on avoiding any loss efforts.

Conditions of application:

- in case of continuous production
- deliveries are realized in small units and frequently
- at delivery, the exact number of packaging is used
- small series are produced
- in-process control is encouraged instead of traditional final inspection,
- helps suppliers to achieve the appropriate level of quality.

Its elements are:

- Total Quality Control
- Equal and flexible production (to shorten in-proction stopovers)
- Production without stock
- Visible layout of the workshop

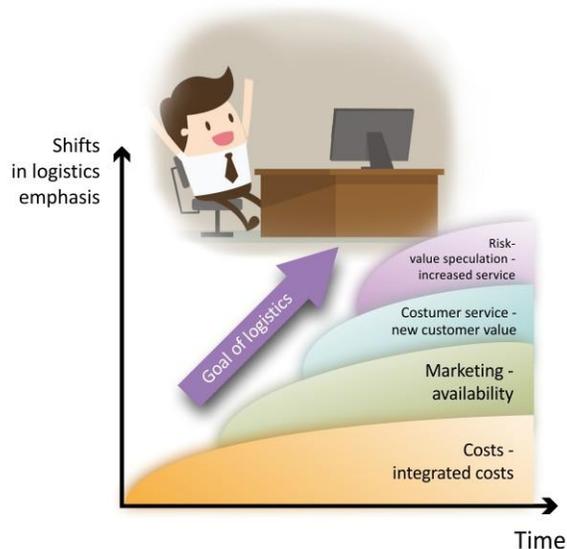
The biggest drawback of JIT system is that the lack of reserve stocks can lead to disruption of production if:

- Suppliers do not keep to time limits,
- the received material / component quality is not good,

- the ordered and properly delivered material is less than needed, this can lead to outage at production
- the company or supplier is not flexible enough and because of rapid change in market needs other products are needed to be produced.

9.2.3 Financial flows and stocks - logistics systems of companies

Logistics in developed market economy started to have more importance since the beginning of the 1950s. First it appeared in the US then East Asia and Western Europe. Application of them dates back to ancient wars, think of the Persian armies, Alexander the Great, or the legions of the Roman Empire, In great battles of the XIX. and XX of the century for example Napoleon, landing in Normandy it was also important to move the armies, ensuring the supply. Nowadays flourishing of modern logistics is due to the revolution in IT. Thus in economy market it has acquired key position. Over the past 60 years, logistics has gone through various stages of development, transformation of priorities and goals as shown in the following figure,



51. 15Figure: Developmental stages of the logistics

In operating processes of companies financial processes play important role, which if interrupted, disrupt operation. At the so called "

breaking points " there is a need to accumulate stocks, to avoid problems. In addition to physical needs, keeping stocks is an economic necessity (shortages, price changes), not only for companies but on every level of the economy, from households to national economy.

- ☞ **Material processes: the flow of various products with different level of preparedness within the company and between companies for example raw materials, work in progress, semi-finished products, finished products, etc**
- ☞ **Stock: The stock of available products at a company at a given time.**

Logistics business deals with activities related to material flows and stocks. There are many definitions for logistics, here is a well known one:

- ☞ **Logistics: A corporate activity, that grants products to be available in the right place, time, quantity and quality in the business processes.**

Enterprise logistics mission is the so-called 9-conformity principle.:

1. appropriate information
2. right material
3. appropriate energy
4. availability of right people
5. in right quantity
6. in right quality
7. at right time
8. in right place
9. at right cost

Logistics system: It is a system of material processes, inventory and relevant information and management structures.

The process begins with the collection of consumer information on customer side, this information flows through the company and material processes are started. Logistics process can be divided into three distinct functions:

A. **Procurement:** Providing material inputs required for the current production (materials, components).

B. **Production Supply**: Solving material supply duties in production process, it is situated between the production phases and management of resource flow.

C. **Sales**: actual technical implementation of customer satisfaction, the physical appearance of marketing channel that connects the company to the consumer.

These logistics functions of the company are realized through three process groups which are inventory, financial processes and information management.

Logistics strategy

Logistics strategy is one of the functional sub-strategies of the company, collection of logistics goals and all the tools required to achieve them. Logistics system has connection to all the functional subsystems of the company, closely interacts to marketing activities and production functions of the company.

At **classification of logistics system** two factors should be considered:

1. **Quality of service**, which is determined by three parameters:

A. Availability indicates if the required needs could be satisfied immediately. This shows readiness of the logistics system.

B. Service time is time passed between demand and satisfaction of demand. This shows the response time of the logistics system, on average, how long it takes from emergence of the demand to satisfaction.

C. Quality of service to the needs and problems that arise. Controls the compliance of answers in the logistics system. Shows capability of the given logistics system. How detailed it takes into account the needs, and what is the rate of the use of replacements.

2. The **logistic costs**, which can be divided into two main groups:

A. The management costs, which include ::

- inventory,
- acquisition,
- sales,
- production supply,
- running costs of the information system

B. Logistics function related to the costs of physical implementation:

- transport,
- storage,
- material handling,
- costs of packaging.

- Improving the quality of service often increases costs. It can be changed at the expense of others, the same can also be said about the types of costs, for example if transport costs are reduced (at a time a bigger consignment is ordered), other costs such as cost of storage would rise. The problem in decision making for the company management is that the two sales factors effect against each other, so constant reflection is required.

The task of logistics strategy: building and efficient operation of the logistics system, achieve the appropriate level with the lowest possible cost. Its components:

A. **Sales strategy:** In this context, the decisions are mainly the responsibility of marketing, whose logistics factors are:

- The creation of the system (transportation routes, location of warehouses etc)
- Timing of demand satisfaction (custom manufacturing or production for stock)
- Transport technology (modes, routes, cargo unit creation, etc).

☞ **Production to order: When the production process starts the buyer is already known.**

☞ **Stock production: Production is done in order to meet estimated, projected demand, customers are not known.**

B. **Procurement Strategy:** Before the 1970s it was regarded as a purely technical function. At the end of the 90s high level cost reduction and rationalization and saving aspects have increased the importance of it. Key factors:

- Buy or produce ("make or buy") - based on economical considerations,
- Requirements to suppliers - Quality, delivery frequency, accompanying transport services etc.
- Selection of sources - the use of one or more suppliers,
- Information systems of acquisition - internal and external information as well.

C. **Inventory Strategy Factors:** Stocking activities are important integrating factors in the operation of companies.

☞ **Inventory Management: The corporate activity designed to smoothen material processes taking into account economical requirements.**

The main strategic factors:

- The *size of the invested assets*: Stocks means assets temporarily withdrawn from recovery processes, thus slowing down the recovery time of the company's capital.
- *Company operation flexibility*: Another aspect of corporate strategy is that operations preserve the flexibility of external relations and internal processes as well.
- *Expenses related to stocks*: The continuous reduction of general expenses is a general element of the strategy. It appears on product level and depend of the sufficient level of products in stock.

D. Strategic considerations related to material processes

- **Placing Warehouses**: two principles (or a combination) can be considered: market-oriented and production-oriented network. In the former case the customer is closer, in the latter case the manufacturer maintains company stores closer to its location.
- **Delivery**: possible alternatives to complete delivery(rail, road, air, and water transportation, pipeline and combination of these).

Integration of strategic factors - supply chain

From the millennium quality, flexibility, low costs and rapidity has increasingly played an important role in production of different products, services.

- **Quality of the product** - Because the variety of similar products it has become important.
- **Flexibility** - Company's ability to respond to customer needs with enough quantity and good composition of the products.
- **Rapidity** as a major competitive factor in the development of new products, and fulfillment of customer orders is an important factor as well.

In strong competitive position on the global market where companies are fighting with each other, a final product is produced by the company chain - **Supply Chain** - . Therefore, the final product is determined by the result of the combined activities of several companies.

- ☞ **Supply Chain: A group of three or more individuals or organizations who directly receive the n products, services, funds, inward and outward flowing information**

necessary to produce final product from procurement to consumer.⁸³

Members of the supply chain with their core activities are connected to the chain through direct partners. To ensure the highest possible usefulness for companies outsourcing "non-core activities " is applied.

☞ **Outsourcing: The company commits to external partners activities, that itself could do, but do not belong to the essence of its activities or it is less expensive in terms of cost.**

Operation of the logistics system

Operation of the logistics system is based on three pillars:

1. **Inventory Management**
2. **The management of the material processes** and
3. **Information system** (which was previously mentioned).

Inventory Management

At companies, two large groups of stocks can be distinguished:

A. **Bought stocks.** Types of which are:

☞ **Materials: working items, which generally lose their shape during the manufacturing process, or service. Their value will be manifested as a product or service.**

Main types:

- Raw- and base material - important part of the product or service. They can be found in original or unchanged form in the produced goods.
- Excipient: an inactive substance that serves as a vehicle to create or sell the product
- Fuel: necessary for the operation of working tools
- Maintenance Materials: for the repair, maintenance of corporate assets, replacement of parts.
- Other substances (eg packaging materials, office supplies, work clothes.)

⁸³ MENTZER, J. T. - DEWITT, W. - KEEBLER, J. S. - MIN, S. - NIX, N. W. - SMITH, C. D. - ZACHARIA, Z. D.: Defining supply chain management. Journal of Business Logistics, 2001. Vol.22., 1–25.p.
http://www.aui.ma/personal/~A.Berrado/MGT5309/DEFINING%20SUPPLYCHAIN%20MANAGEMENT_Metzner%20et%20al.%202001.pdf

 **Goods: products that have been acquired in order to resell them in the same state.**

B. **Own produced stocks**, produced by the company itself:

- Unfinished production: undergoing treatment of products, products awaiting further processing, on which at least one production process is carried out .
- Semi-finished products: they have gone through a complete machining process, taken to warehouse or available for warehouse.
- Finished product: a product which is right after the required technical conditions, after quality takeover it is taken to the warehouse, finished as a marketable product.

Conducting material processes

The **management of financial processes** is going through the following activity groups:

- **Transport**, the delivery of products from suppliers to the company, respectively company to customers.

Main questions are:

- The way of technical transaction
- The implementation performing organization (within the company, suppliers, subcontractors by mandate etc).
- Material handling includes:
 - material handling between plants;
 - warehouse material handling;
 - handling in-house;
 - material handling between economic entities.
- **Storage** allows the company to accumulate a sufficient amount and type of products before delivery. Storage can be in own or outsider's warehouses - economic considerations decide.
- **Packaging** preparing certain products to transport. Handling and marketing points of view are dominating.

9.3 SUMMARY AND QUESTIONS

9.3.1 Overview

Value creation processes are the company's resources transformed to consumer value. The types of the main production processes are defined by the type of the production system and the kind of mass production.

The main types of services are related to production and consumption. Production and service decisions concern the design and use and the principles of the organization of production. Production is based on design and implementation of financial flows, machining processes and integrated management of stocks. The main elements of this system are production design, the essence of which is needs planning system (MRP) and implementation. Logistics is responsible for ensuring that the necessary materials, products are at the right place and time, and required quantity, quality and variety are available. Logistics system can be divided into three subsystems: sales, production and supply purchases. The two main elements of logistics operation system are inventory management and management of material processes. Stock management is an integrating factor for the company's operation because the different types of stocks are directly related to the operation of all sections. Running material processes requires coordinated solution to transport, storage and materials handling activities.

9.3.2 Self-check Questions

- Explain the concept of value creation processes and components!
- Explain the concept of production, group the production processes from several aspects!
- Explain the concept of service, specifications, group service processes from several aspects!
- Describe the main phases of the technology lifecycle!
- Explain the concept of material assets, and their role in production!
- Define the concept of computer integrated production, describe the components!
- Explain the concept of MRP and the three main components of the system!
- Explain the concept of logistics and its functions!
- Describe the aspects of classification of a logistics system!
- Describe the tasks of logistics strategy!

9.3.3 Practice Tests

1. The service is marketable which has unidentified scope of use. FALSE
2. The composition of a company's tangible assets basically is not affected by the company's profile and strategy. FALSE
3. Starting point for integrated production planning is provided by the assessment of the existing resources (materials, machinery, labor .etc) FALSE

4. Availability indicates the average length of time from when the claim arises until meeting it. FALSE
5. Reduced transport costs generally increase storage costs. TRUE
6. At companies two large the stock groups can be defined: semi-finished products and finished products. FALSE
7. Modern production management system (Manufacturing Resource Planning) appears embedded in business processes closely linked to other functions, for example. marketing, logistics, HR, and finance. TRUE

10. QUALITY MANAGEMENT

10.1 GOALS AND COMPETENCIES

To the millennium high quality has become important in all branches of economy. The unit's goal is to give knowledge about the concept of quality, we will go through how modern quality management was created, we will show the elements of ISO 9000 standard series and TQM quality centered philosophy of corporate governance. It is important for the student to:

- know the role of quality, and its importance in corporate sector,
- be able to group the aspects and dimensions of quality,
- be able to characterize the development of quality management history,
- distinguish between main differences of Japanese, American and European Quality schools,
- know the roots of quality management progression and know ISO 9000 concept and goals,
- understand the principles of ISO 9000 standard,
- know the system and connection among the elements of the standard,
- know the concept of TQM and the model of it,
- be able to group and characterize the process of the principles of TQM

10.2 CURRICULUM

We will look through the role of quality management and interpretation from different aspects. Meanwhile we discuss the evolution of quality management, we explain the specifications of the different phases, and we will see the main activity of experts in quality schools. If an organization aims to deal with quality tasks, they have to have the similar path, like the evolution of quality management. The company quality culture development could go on this "way" from the basics to the highest level, to TQM. The main topic of the unit is ISO 9000 standard series: Its emergence, concept, goal, principles. Studying ISO 9000 model will let us know more about the fields that the model wants to control. In corporate quality politics there is a need for a quality management documentation system, that has two functions: On the one hand it regulates and makes a clear view on the process, and on the other hand

it gives consistency with corporate strategy. The last third of the unit is TQM quality centered philosophy. We discuss the 4 principles of TQM and interpretation of the process and mechanism to implement it.



52. Figure: Corporate quality management

10.2.1 The Role and interpretation of Quality

In the 21st century quality has become one of the most important things in economy. It is now as important as price and precision of delivery. Quality is needed in every area of economy. No production or service organization can afford themselves not to use any of the instruments, methods of a quality management system. The concept of quality was created that is why quality management systems have been created as well. At the beginning of the millennium the developed world had to face the following economic and social challenges:

Globalization and consequences - EU, EFTA, corporate acquisitions and fast spreading of management technologies, also the dimensions of competitors have changed.

Spread of techniques supporting new, fast changes - IT, web, communications - (with all the consequences)

More **conscious customer - consumer behavior** - environmental and life-cycle perspective purchases, needs for sustainable economy, etc,

Stronger human aspects and close connection to **the concept of knowledge based society**

As a result of it market competition has started to be stronger, faster and have more dimensions. To increase corporate competitiveness:

- Traditional organisational and managing methods **are not always able to give right answers** on market challenges.
- To choose management technologies and to use them we need **bigger horizon and up-to-date, special knowledge.**
- Quality as a philosophy is **a global competition and efficiency.** Classical quantity competition then price competition has been followed by **quality competition** in the past ten years in developed industrial areas. 30-40 years ago if a company made a good quality product, it made enough profit. After the millennium quality started to be a potential to enter the market.

The connection of corporate position and product quality

Product quality is more and more important for the company, it determinates the position for them on the market:

Market role	Before 1980	1990	2000	after 2000
Enter the market	suitable product	acceptable costs, suitable product	product quality acceptable costs, suitable product	product quality customer satisfaction acceptable costs, suitable product
Successful operation	acceptable costs	product quality	customer satisfaction	new value for the buyer
Market gain	product quality	customer satisfaction	new value for the buyer	balance of the expectations of the parties and internal efficiency

53. Figure: Product quality and company position in the market⁸⁴

Quality has moved to a higher level, it is important in every corner of the economy. Both production and service organizations have to work with the methods and instruments of quality management. (The system is not only a certifiable quality system) The emergence of these systems are connected to the change of quality concept, partly this is the trigger that has made changes towards the different quality approaches, systems and use of these systems. The concept of quality has changed a lot during the past ten years. The changes in technology have made changes in the quality of people's lives: Transport, ICT devices, and energy sources. In the literature we have found the following grouping:

*Interpretation of Quality*⁸⁵

There are many quality definitions, you can even group them:

"Quality is the essential characteristics of an object, process "
Hungarian Thesaurus

Manufacturing based quality definitions

⁸⁴ Source: NAGY, ZSOLT: Qualitymanagement, Berzsényi Dániel Főiskola, Természettudományi és Műszaki Kar Szombathely, 2007., 7. p.
http://www.nyme.hu/fileadmin/dokumentumok/atfk/tematikak/HUMAN/MA_any/MA_Minosegmenedzsment.doc

⁸⁵ CSÉFALVY, MIKLÓS: Principle of quality, quality movement, quality systems, Távoktatási modul, Óbudai Egyetem, KKVK, Mikroelektronikai és Technológiai Intézet, Budapest 1999., 9-10. p.

"Quality is adequacy to requirements" Philip B. Crosby

"Quality is a measure if the product is fit to designs and regulations"

Harold L. Gilmore

User based quality definitions

"Quality is suitability for usage" J. M. Juran

"Total quality is output of managers which can satisfy the user's needs right at the first time" Westinghouse

"Quality is meeting the buyers' expectations. Continuous improvement in quality, the principles and policies are designed to support structures and practical operation to continuously develop output and efficiency" AT&T

" Buyers satisfaction is when the buyer comes back not the product, that you have sold" Stanley Marcus

Product based quality definitions:

"Quality differences reflect on quantity difference of some required components and peculiarities" Lawrence Abbott

"Quality concerns a collection of peculiarities not to be expressed by money which are involved in peculiarities of each unit expressed by money." Keith B. Leffer

Value based quality definitions:

"Quality is the extent of excellence compared to acceptable price and its regulated alternatives alongside with acceptable costs." Robert A. Broh

"Quality means answering to certain customer conditions, which are: (a) practical usage and (b) sales price of the product" Armand V. Feigenbaum

Transcendent quality definitions:

“Quality is neither mental nor material, but a third entity, independent of the other two.... which cannot really be defined, yet you know what it is in reality” Robert Prising

“ A state of excellence means refined quality which is different from poor quality. ... Achieving quality is meeting the highest standards as opposed to being satisfied with superficial or unfair” Barbara W. Tuchman

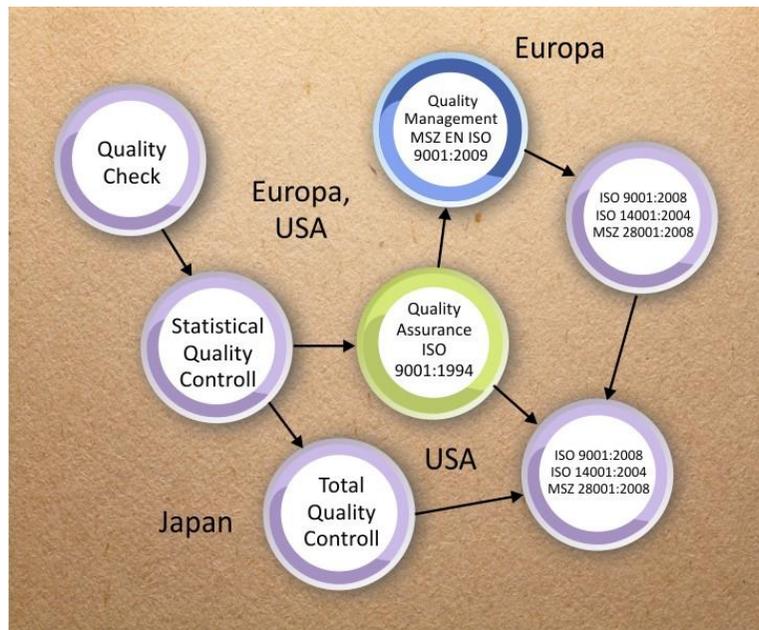
Eight dimensions of quality system:

1. **Performance** - main specification of a product, or service (eg. acceleration of a car, how comfortable it is to wear permanent contact lenses).
2. **Special attributions** - additional items, extras (eg. guide to a course, central lock in a car)
3. **Reliability** - malfunction, probable failure in time (eg. 5 years, 100.000 km guaranty)
4. **Competence** - How the product design- and performance characteristics meet the accepted standards (eg. a product's characteristic size is within the standard value - 0.025 mm)
5. **Durability** - Lifetime of the product (eg. 10 years)
6. **Maintainability** - Repare is fast and easy (eg. circuit board that can be changed by the user)
7. **Aesthetics** - how the product looks, feels, tastes, smells (eg. a rose has a special feeling, desired color and distinctive fragrance)
8. **Perceived Quality** - quality from the customer's point of view (eg. a parent uses removable diapers because they are available in a hygienic, comfortable shape and at reasonable price).⁸⁶

10.2.2 Quality History

Quality management, as a science started at the beginning of 20th century, when Taylor started "science management". This is the time when they started to use management principles in production to increase efficiency. The development of quality management took place in several stages, as you can see it below.

⁸⁶ GARVIN, DAVID A.: Competing on the Eight Dimensions of Quality, Harvard Business Review, 1987 nov-dec. 101-109.o.



54. Figure: Evolution of Quality⁸⁷

1. Quality control (1900-1925)

It has a history far back in the time, guilds had it, but we can think of the Pyramids as well. At the beginning of the 20th century people started to use science based management methods to increase quality. Following the methods of F.W. Taylor some independent, trained, quality inspectors went to factories that is how quality control started. They only did last check on the items or on services, they measured one or more specifications and then it was controlled aiming at a desired value. This activity only showed the failure but no causes so there was no further development.

⁸⁷ Source: POLÓNYI, ISTVÁN: Bases of Qualitymanagement, Debreceni Egyetem Közgazdaságtudományi Kar Menedzsment és Marketing Tanszék, 2007., 40.p. <https://dea.lib.unideb.hu/dea/handle/2437/97104>

Primary aim	Stating the problem
Way to achieve quality	Solving quality problems
Focus of activity	Homogenous product
Methods	"Standardization" and measurement
Task of quality experts and organization	Control, selection, calculations, qualification
Responsibility for quality	Quality control unit
Approaching quality, orientation	"Control" of quality

2. Quality regulation (1920-1960)

With the spread of mass production and with bigger quantities statistical sampling was necessary. The development of probability theory helped a lot at these times. Process control emerged, production and engineering departments were responsible for quality, this is the time when correction got a role.

Summary:

Primary aim	Control and regulation
Way to achieve quality	Solving quality problems
Focus of activity	Homogenous product with fewer control
Methods	Statistical tools and technics
Task of quality experts and organization	Elimination of mistakes and application of statistic methods
Responsibility for quality	Production and other technical units
Approaching quality, orientation	"Regulation" of quality

3. Quality (quality assurance) systems (1950-1985 USA, Europe)

At this time at companies there were sub-quality systems showing up. These involved production departments and processes and all kinds of parts in the lives of companies connected to the buyers needs. The goal was creating regulated systems for optimal operation aiming at coordination of the work of the departments involved directly or indirectly in satisfying customers' needs.

Summary:

Main goal	Coordination
Way of achieving quality	Fixing quality problems
Activity emphasis	Wider production chain, focused on error prevention
Methods	Quality projects and systems
Quality experts and tasks of the organisation	Quality planning, quality - programs, quality system evaluation
Responsibility for quality	All sections
Quality orientation	Structure of the quality system and operation

After the II. World War quality management split up to three parts, the literature calls it "quality school" where the three parts have distinct specifications.

American quality school

The base of it is a highly motivated and committed, successful senior manager layer, who work together with skilled workmen so they produce high quality products and services. In the development of quality management the following experts had determinative role:

- **Walter A. Shewhart** worked at Bell Labs as a statistician. He evaluated the differences during the production with simple statistical tools: eg. sampling, probability theory.
- **F. Dodge és H. G. Roming** during World War II elaborated MIL STD 105 standard (military standard) which is related to the reception of products: they took a product (a part) and they take a sample, control, and test it and in the end of the process they decide that they accept it or refuse it.
- **William Edwards Deming** in 1950 trained Japanese Engineers. He developed the top-down controlled quality management, the improvement of quality should be shared among the different layers. (Father of PDCA cycle)
- **Joseph M. Juran** realized that low quality comes from wrong preparation and not effective design. He created Pareto-principle in quality management: 80% of upcoming quality problems are due to 20% of the committed failures.

- **Armand V. Feigenbaum** was a manager at the General Electric at the section of production and quality control. All functions are responsible for quality in an organization, so there is no quality production if,
 - the product is not well designed
 - the product is on wrong market and there
 - is no good relationship with the costumers.
- **Philip B. Crosby** has four thesis related to quality:
 - quality is not about the elegance more about the needs
 - prevention is primary rather than control
 - the expected level of performance is zero error
 - the volume of quality is equal to the cost of quality

The Japanese quality school

In 1950 USA helped the Japanese industry to get back on track, the American quality philosophy was converted into the values of the Japanese. (collectivism, stability, the desire for perfection, work discipline, precision, etc.). Deming and Juran had big role in it, too. Specifications of the school ar the following:

- targeted, age based, layer-by layer intensive education in companies
- quality assurance from input market to output market (Total Quality Control)
- show up of the quality circles, emergence of " [building from below](#)" [quality management](#)

After 20years of development Japan became a rival for the USA in industry.

Main representatives:

- **Kaoru Ishikawa** father of quality management, he had 3 thesis:
 - everyone should use simplified quality techniques (democratization of quality)
 - the quality management has to cover the whole company
 - the "quality circles" are the main driving forces of Japanese companies
- **Genichi Taguchi** lack of adequate quality leads to consumer's dissatisfaction, increase of the warranty costs, losing reputation and finally it leads to the loss of the market share.

European quality school

It is coming from the basic rules of the guild systems and from the standard system of measurement units (SI). Quality assurance is important for European quality school. The given system is covered by systematic fault finding and repair procedures. Key concepts are documentation, auditing, formalization, regulation. Review and evaluation has an essential role, quality audit and certification method closely connected to ISO system standards has importance as well.

1. TQM - Total Quality Management

In 1990 a combination, a mixture of the 3 quality schools formed a new approach to quality management. It is a management philosophy that uses human and material resources available to the company the most effective way. It covers not only the process but also the management of resources and also focuses on customer satisfaction and continuous development of organizational performance.

TQM has changed a lot in the previous views of quality:

- quality is not only technical or aesthetic concept (it is not only the product and / or service but also concerns processes and organizations) it is now a **business category**.
- before we characterized quality after technical specialization but now it is characterized by **extent of satisfaction of the ones** concerned (users, customers, shareholders, employees and society)
- "good quality is expensive" approach is changed to "**economical quality**" so nowadays expectations mean "good for the first time"

Summary:

Primary aim	Strategic influence
Way to achieve quality	Ensuring permanent competitive position
Focus of activity	Market and consumer needs
Methods	Strategic planning, systematization of aims, mobilization of the whole system
Task of quality experts and organization	Systematization of quality aims, training, support of other units, planning quality programs
Responsibility for quality	All employees with devoted supervision and participation of management
Approaching quality, orientation	Quality management system

10.2.2 Quality controlling systems and the ISO 9000 standard family

We can mention a lot of different quality controlling systems from our past like the Bible, Hammurabi king of Babylon mentioned in his book or 1st Peter tsar's military industry decrees. In the 20th century mainly because of military orders it was needed to have processes that are stable and reproducible with the same level of quality and minimized possibility of mistakes. After the development of corporate quality assurance subsystem Europe aimed the development of quality systems. With corporate quality assurance subsystem not only the production and service were dealing with quality but all the services and processes are involved that is connected to outer and inner customer satisfaction needs. The model aims to have a working system and to reach optimum operating. To have this there is a need to have a quality IT background. Quality management is typically customer sided it came from the needs of Military Industry, nuclear energy, automotive and pharmaceutical industries, etc. The examination with any kinds of method of products or services was changed to the examination of production organization capabilities. While this put more tasks (measurements and controls) to the suppliers, the confidential nature of relations strengthened. This was the ground for international standardization and certification and supply chain management as a method to spread. There are many kinds of quality systems that are known for us but usually they are built based on ISO 9000 standard series. These standards give clues, specifications to create quality systems. Introducing the system it makes awareness on quality connected activities. ISO 9000 helps to the existing but

uncoordinated systems to start to operate under a single logical order eliminating this way quality fluctuation.

Military standards, industry quality systems, origin of the ISO 9000

After World War II in the years of the Cold War space, aerospace- and military industry started a fast development, so it was important to have maximal reliability and safety. Military industry elaborated material receipt- and complex production management and control systems.

- In 1959 and in 1963 the US Department of Defense introduced MIL-Q-9858 and 9858A quality programs
- In 1968 the NATO introduced AQAP-1 quality control program, later military suppliers took it over: Westinghouse, General Dynamics, Ford, GM
- In 1987 ISO - International Organization for Standardization following the British BS 5750 standard created ISO 9000 system standard
- ISO took the responsibility to review, evaluate periodically how the standards are appropriate to the original goals and the changes in market and social expectations. Later they released standard EN 29000:1987.
- The first review was in 1994 this version had many changes. Then with label EN ISO 9000 it was released again. (ISO stands for international standard, EN stands for valid standard in the European Union)
- In Hungary it was released in 1996 under the name of MSZ EN ISO 9001:1996. Its specifications were the following:
 - The system was prone to stagnation, it was not motivated for business success
 - It did not care about the workers motivation, it was not based on motivation rather on expectations (reviews instead of self reviews)
 - It did not start out of customers needs, it was not about the customer's satisfaction
 - Schematic documentation, standard oriented, it was hard to apply to service and non-profit organizations
- After remarks in 1995 they planned to review the ISO 9000. In the year 2000 in December they released the new, modern ISO 9000:2000 standard family.
- After the millennium they changed the standard again:

ISO 9000:2005 / MSZ EN ISO 9000:2005/: QLS-Bases (QLS - Quality Leading System) it is a so called vocabulary to understand the standard.

ISO 9001:2008 / MSZ EN ISO 9001:2009/: QLS- requirements It is a so called requirement standard. This contains the requirement that the user of the system has to fulfil.

ISO 9004:2000 / MSZ EN ISO 9004:2001/: QLS- guide It is a so called development standard. Contains a series of recommendations, guidelines that aim quality management system development.

ISO 9000 standard family and goal

ISO 9000 is the most widely used standard series in economy, nowadays it is an international system of requirements. It is a unified guidance to enterprises about:

- Size
- Activity
- It is applicable regardless of the economic sector
- the business sector,
- the public sector, government agencies,
- Non-profit organizations.

Specifications:

It is generally applicable standard family, is **not tied to any branch of industry**

It is called "system standard" or "management standard" **NOT product standard**

It is not about total management - like the TQM- because it does not regulate management (financial) processes

The system is **not necessary world standard** but it grants stable and reliable product for the customers

The system is inspected periodically by **independent, accredited certificated institutions** in case of compliance they issue a **certification document**.

At the moment it is introduced in 170 Countries and more than 1million companies are using it.

Why it is important for a company to introduce ISO 9000?

It helps and guarantees:

- the quality of products and services
- continuous improvement
- increase in customer satisfaction
- satisfaction of customer requirements on a higher level

Due to the growing local and regional competition it is used in the whole company and all over its operation. The quality leading system guarantees inside the company:

- transparency of processes
- reasonable documentation of the activities
- allows daily control of the process.

In addition it helps with:

- creating mutual understanding among market players (terminological- physical quantities, the interpretation of the technical requirements of products)
- cost reduction
- increase of safety, life, health and environment protection
- consumer interest protection

What kind of motivations can lead to take ISO 9000 certification?

- one or more customer expects it at contracting
- the firm expects that sooner or later there is a claim for it
- the firm takes the certification as the most logical and efficient way of managing quality.

The ISO 9000 Principles

1. **Customer oriented organization:** the organization depends on the buyers that is why it is good to know the buyer's current and future needs. It has to satisfy the customer requirements and expectations.

2. **Leadership:** the leadership has to decide about the goals of the organization. The leadership have to create the inner work environment in which employees can fully be identified with the organization's goals and tasks.

3. **Staff participation:** The staff is the most important part of the organization's operation, at all levels, in order to reach the goals of the organization.

4. **Process-based approach:** the desired results are more effectively achieved if the resources and activities are treated as a process

5. **System approach and management:** efficiency and effectiveness if the organization improves identification, understanding, and managing the processes

6. **Continuous improvement:** The main objective of the organization is development

7. **Evidence-based decision making:** Effective decisions are based on the analysis of data and information.

8. **Mutually beneficial supplier relationships:** The organization and its suppliers are dependent on each other, mutually beneficial cooperation is beneficial to both parties.

The structure of ISO 9000 system:



55. Figure. The structure of ISO 9000⁸⁸

- On both sides of the figure there are the buyers with their expectations, requirements and satisfaction. The functions of quality management are **exploration and understanding** of customer requirements and expectations, the **goal is** to satisfy the buyer meanwhile it **measures** the level of the performance of duties. After the results they correct the subsystem (production process). PDCA can be applied to any transaction, activity, process, system operation, concept. It is a closed loop, a continuously repeating cycle-principle. In international literature it is called Deming's Cycle, PDCA Wheel, PDCA Cycle or PDCA Loop. Parts of the PDCA Cycle are:
 - P - Plan!

⁸⁸ Source: ERDEI, JÁNOS – NAGY, JENŐ BENEC – TOPÁR, JÓZSEF – TÓTH, ZSUZSANNA ESZTER: Qualitymanagement Educational resource material for master's degree in Management and Leadership, Budapest, 2010., 11.p.
http://bme.ysolt.net/GTK_MuszakiM_MSc/S1_Minosegmenedzsmnt/Minosegmenedzsmnt_jegyzet.pdf

- D - Do!
- C - Check!
- A - Act!

Critical areas of the organization's **internal operation** (these processes need to be regulated):

- To ensure **senior management commitment to each affected area**: They define quality politics, quality goals in the interest of successful operation. They provide the necessary resources, active and exemplary conduct, their activity serves as a model for subordinates.
- The main task of senior management is **responsible management of resources**: ensures that the necessary material and human resources are available in the right place, quantity, quality and the management creates the right working environment for effective use.
- During the **product production processes** the organization needs to design a system of processes that are required for the production of the product / service.
- **Measurement, analysis, development** has to answer for the wrong products / services. (How can they be changed, modified to good if a product / services is wrong.)

The main goal is to improve corporate performance through the development of quality management while the customer is satisfied.

Organizational documentation of the ISO 9000 quality management system

Any effective quality management system has a function to determine a multi documentation system. Its functions are multi leveled: on the one hand it regulates and makes the production / service processes transparent, and creates consistency in the organization's strategic objectives. **The documentation depends** on the size of the organization, activity, complexity and preparedness of the staff.



57. Figure: The pyramid structure of documentation⁸⁹

The quality management system documentation must include:

- A. Documented statement of quality policy and quality objectives,
- B. Quality management manual,
- C. Documented procedures and records required by the International Standard,
- D. Documents specified by the organization, including records that are necessary to ensure the effective processes of planning, operation and control.

Detailed definitions are:

- 📖 **Quality policy: Formally formulated general intent and guidelines for quality by the senior management. Quality policy is generally consistent with the general policy of the organization and provides a framework for quality targets.**
- 📖 **Quality objective: the level of quality that you want to maintain or achieve. Quality objectives are generally based on the organization's quality politics, and usually they will be pursued by the organization for relevant functions and levels. In order to achieve measurable quality objectives,**

⁸⁹ Source: SZINTAY, ISTVÁN – BERÉNYI LÁSZLÓ – TÓTHNÉ KIS ANETT: Quality Basics, Miskolci Egyetem, Vezetéstudományi Intézet, 2011. <http://www.szervez.uni-miskolc.hu/blaci/minmen/index.html>

there must be commitment to quality and continuous improvement in line with the policy.

The achievement of quality targets favorably affect product quality, operational effectiveness and financial effectiveness, through them stakeholders are satisfied and confident. The main areas affected by quality objectives:

- Ability to continuous renewal in the area of service development
- Long-term sustainability
- Teaching and education of sustainability and quality
- Partner-focused operation and communication
- Efficient and result-oriented operating of resources
- To achieve a healthy and safe environment

Content of Quality Management Manual:

- The application area of quality management system, including details for any exclusions
- Documented procedures or references in quality management system
- Descriptions of interactions between quality management system processes

Quality assurance procedures, product manuals include products / services, product quality and production, storage, transport, description of standard processes, the name who is responsible for the process and location.

Instructions for Quality Management System include the ways in which the procedure indicated in the previous paragraph is realizable in the expected way.

Documents, notes, records include a variety of product- and process tracking documents, quality records, testing, measurement protocols, statistics, analyses.

- Records of compliance and proof of successful operation of the quality management system **should be under supervision.**

The organization must establish documented procedures of records

- to identify
- to store
- to preserve, to search
- to control rejection.

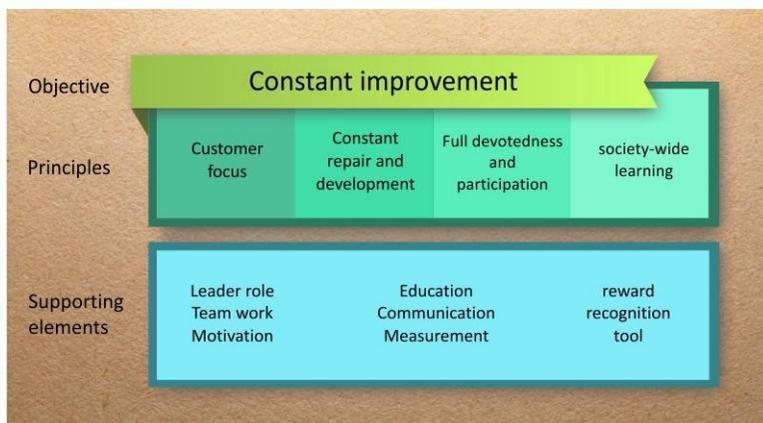
- ☐ The records should stay readable, identifiable and must remain to be searched.

10.2.3 Total Quality Management - TQM

☞ "TQM is a business method:

- where quality stays in the center,
- based on the participation of all members of the organization,
- aims at long-term success, and takes satisfaction of the consumer into account
- in the way that it takes into account benefits of all the members of the society, and the company."

"Products and services born with quality as a core business strategy fully satisfy both internal and external customers by meeting the spoken and unspoken expectations." Tener and DeToro (1996)⁹⁰



58. Figure: The TQM model

In the second half of 1980 Total Quality Management spread worldwide -, that is a strategy of complex quality assurance systems wich is a top-down quality management system (described in BS 7850:1992 standard) The model of TQM has **4 principles and 8 additional principles**. TQM takes quality management as a managerial task, so it includes the organization's management philosophy, the associated strategy and a variety of techniques for

⁹⁰ TENNER A.R.-DETOROI.J.: Total Quality Management. Műszaki Könyvkiadó, Bp.1996

implementation. The goal is to create a process that has an impact on quality in the **whole company** even on the improvement of the quality of the whole process. The introduction of TQM is possible in many ways, so the different economic, social circumstances can cause significant differences in TQM systems. However, there are some features - principles which are identical and appear in each TQM model.

Customer orientation

Condition of the firm's long-term success is the ongoing compliance with customer expectations, key areas of which are:

A. **Identification of the customer**: Concept of customer has changed in the interpretation of the TQM compared to the everyday meaning. It says buyer is who receives the product from an individual. It has two types:

- external customer: outside the organization
- internal customer: staff members who give product to each other (parts manufacturing workers - assembly worker, in their relationship the latter one is the buyer of the former one)

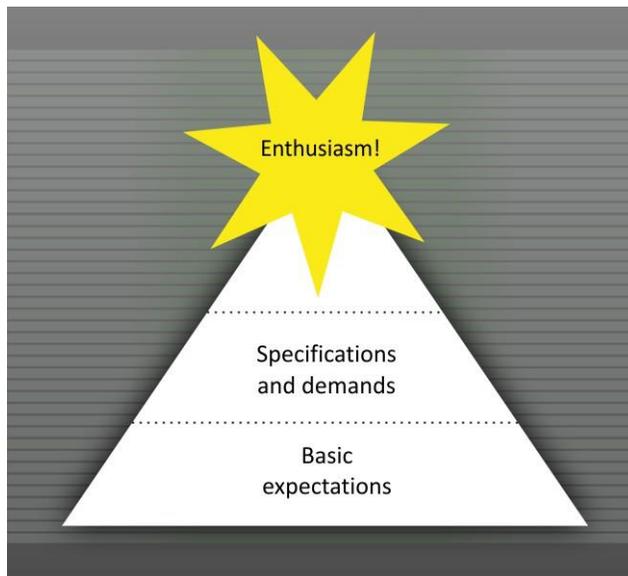
☐ The external customer's needs are satisfied 100% if internal units receive 100% perfect products from each other.

B. **Mapping Customer Expectations**: The main objective is to satisfy the latent demand

Principles:

- Quality is determined by the customer. The aim of TQM is to meet it.
- The customer does not always know his demands, so he should be involved in the early development phase = identifying latent demand.
- Open minded approach is needed (attention must be paid on the changes of the market dynamics, introversion may result in market loss)
- The workers of the organization should know how to accept the products and services, so that is how we can talk about total customer focused concept.

🛖 **Latent demand: Features that are wished by the customers, but they do not know if it is available for them, therefore they are not able to formulate them in negotiations with suppliers.**



59. Figure: Customer demand levels⁹¹

- **Surplus Value Level:** they represent the added value extras which the customer do not know about, but very pleased to receive, they are latent demands: eg. GPS mobile phone
- **Optional power levels:** the customer is free to choose among these factors, they are stated demands: eg. waterproof phone.
- **Minimum performance levels:** its presence is at all times an unspoken need: eg. be able to call with a mobile phone.

C. **The mechanisms for understanding customers:** three levels based on one another are possible to examine:

- What are the **distinguishing features** of their products and services that are important to customers?
- **How satisfied** are customers by the characteristics of the offered products and services ?
- **How satisfied are they with the rivals?**

⁹¹ Source: TOPÁR, JÓZSEF: Quality management educational material, Budapesti Műszaki és gazdaságtudományi Egyetem, Menedzsment és Vállalatgazdaságtan Tanszék, Budapest, 2005., 54.p.
http://www.epito.bme.hu/vcst/oktatas/feltoltesek/BMEEOVKASG5/min_tqm.pdf

Level 1

- reactive approach: Only a minimal attention is paid to the customer's understanding, it is mostly collecting complaints. However, this way several problems show up:
- not typical, angry customer information is received
- only a limited number of customers provide information voluntarily to suppliers
- mostly there are no such data summarizing and analyzing systems
- the employees are too busy with the customers' problems or they have to defend themselves against accusations
- methods are: customer complaints services , eg. customer service, compensation of the customer, employee training to customer treatment, etc

Level 2

- active approach The primary objective is to communicate with the customer, responding to the questions, which may include,
- information desks
- hot wires
- analysis of turnover data
- feedback from the customers' representatives
- unstructured surveys

Level 3

- a proactive approach The main goal is to get "perfect" knowledge of the customer, the main methods of which are.:
- personal interviews
- group discussions
- planned surveys
- "mystery shopper": undercover people to try application of the services of the company
- Target groups: you may have a look, which neither surveys nor individual customer conversations cannot be gained from
- Interviews and surveys conducted among former customers: Communication with previous customers can provide specific objective data about our products and services as opposed to communication with present or future customers.
- Matching competitors: for example. using different levels of benchmarking.
- To sum up the conditions of successful customer focused approach:

- To communicate with the customer there are numerous methods
- Adaptation of several methods together is required
- Adopt proactive approach
- Apply this approach to external and to internal customers of the company as well

Continuous improvement and development

Business leaders are often accused of being short-sighted as they only deal with short-term problems. A key to build a long-term perspective is that the business focuses on its processes during its activity. The conditions shall be determined as following:

A. Who are the participants in the process?

B. What processes can be identified?

C. What basic techniques can improve the performance of the process? (for space reasons will not be discussed, but the process management section)

D. What are the principles and methods of performance measurement processes? (for space reasons will not be discussed, but the process management section)

A. Participants of the process:

- Customer: the person (or people) whose product or service is produced. The customers are the people who benefit directly from the product or service, or it is inserted into their own workflow.
- Working Group: The person (or people) who work in progress that produces or deliver the desired product.
- Supplier: The person (or people) who provide input to the workflow. The people who are in the process of actually customers of the supplier.
- Administrator: The person (or persons) who is responsible for the operation and to improve the process.

B. Grouping Processes

- Main processes are activities related to meeting customer / partner processes such as needs. purchasing and sales processes
 - significantly contribute to achieve the goals of the organization
 - external customers are at the beginning of the process and also at the end

- direct impact on customers
 - Supporting processes are following the main processes and provide information for example marketing processes
 - Additional processes are slightly connected to the basic processes. Without these functions essential functions cannot be carried out effectively. for example maintenance processes .
 - Management processes such as the organization's management and definition and implementation of the strategy
 - Key processes basically influence the success of the organization for example some kind of manufacturing process
- ☐ For quality management systems are essential the management of key processes.

C. Process management phases

1. Choosing an Administrator a person or group who are responsible for process planning, running and maintenance.

2. Design to provide a structured and disciplined approach that helps to understand, define and document all the components and their interactions to each other during the process

3. Check ensuring efficiency in order to get all the products according to the customers' expectations

4. Measurement of data, accuracy and frequency control to satisfy consumer needs

5. Correction: The integration of identified improvements

6. Optimization: Increase the efficiency and productivity with the installation of the final corrections.

Full commitment and participation

The total commitment aligns and summarizes each group's efforts: leaders, workers, suppliers. Leaders have the key role, because they distribute TQM principles to all the other groups.

Leadership principles:

1. The leader's decisions are based on data, opinions are interesting, but decisions must be based what the concerned knows and not what he thinks.
2. Leaders are resources, coaches and helpers to their co-workers.
3. Leaders are actively involved in the process, they acquire the new knowledge with their subordinates. This way experienced leader can help the others in their permanent efforts for perfection.
4. Leaders teach commitment. They help everybody to understand the goals, visions, values of the organization. They help each worker to understand their own position and this way they try to contribute to common efforts.
5. Leaders are trustworthy, they bring out the best as possible, and encourage personal development.
6. Leaders are able to be thankful, they do this in every conceivable form of material and non-material incentives.

Society-wide learning

Share of well known methods (for example ISO 9001 forum, quality prices, help of the suppliers eg.) and for the business life it is the **creation of the quality culture** and even the creation of proper external connections with customers, suppliers, rivals, and to the society.

Beyond TQM

The TQM in the 21st century should not be regarded as absolute total since it only optimizes value chain made by the connection to suppliers, organization and customers, it **does not satisfy other stakeholder's needs** nor does it discuss it in sufficient detail.

Opinions have been expressed that by the beginning of the third millennium, the world will exceed TQM and BPR approach, this means that we will need **to redefine the entire business**. New products, new services are needed to be offered to consumers and stakeholders, **taking into account sustainability**.

TQM could have an important role as a leading philosophy but it has to broaden the "competition rules". It is recommended to build in new principles to improve quality principles such as:

- win - win

- Corporate Social Responsibility
- Ethical business behavior, ethical codexes
- Environmental and sustainability declarations
- knowledge management, „wisdom management” as a value, expectation in the TQM toolbar.

10.3 SUMMARY AND QUESTIONS

10.3.1 Summary

The 21st century quality has an important role in economy and in strategic approach of companies as well. Nowadays methods and instruments of quality management in the business sphere are necessary. The interpretation of quality has changed many times in the last 100 years, nowadays it is customer- society oriented. It is observable in relation to quality schools that some approaches are integrated and manifested in the TQM concept. The European and American quality schools had a great influence on the birth and spread of the ISO standard system. The ISO 9000 standard system has guidelines on the operation for various organizations so they operate more efficiently and effectively. The goals in quality politics could favorably affect the improvement of product and service quality and may contribute to both the internal and external stakeholders mutual satisfaction and confidence. TQM is a quality philosophy / leading principle that focuses on quality.

10.3.2 Self-check Questions

Explain the reasons for the appreciation of quality in the economy of 21th century!

Describe the certain groups of quality definitions!

Describe in a few sentences the stages of historical development of quality!

Compare the Japanese, American and European quality schools!

Explain the concept of ISO 9000 family of standards and purposes!

Draw the diagram of ISO 9000 structure and explain its operation!

Describe the elements of ISO 9000 documentation pyramid!

What is TQM, and what are the basic principles?

Describe the key elements of customer-centered approach!

Define the most important tasks of continuous improvement and development!

10.3.3 Practice Tests

1. Quality is no longer just a technical or aesthetic concept (it is not only product or service but process and organization, too) so it is a business category. RIGHT
2. The goal of TQM is to create a process that covers the whole manufacturing process that is how it impacts on quality. FALSE
3. Understanding the customers on a reactive way means, that the company pays minimal attention to customers, it is mainly about collection of complaints. RIGHT
4. Main processes are the fundamentally affective processes in the life of a company. FALSE
5. In the perspective of TQM the interpretation of a customer has changed. An individual passes a product to a customer. (can be internal and external customer as well). TRUE
6. TQM principles include continuous improvement and development. TRUE
7. TQM philosophy originates from the Japanese quality school. FALSE

11. FINANCES OF COMPANIES

11.1 OBJECTIVES AND COMPETENCIES

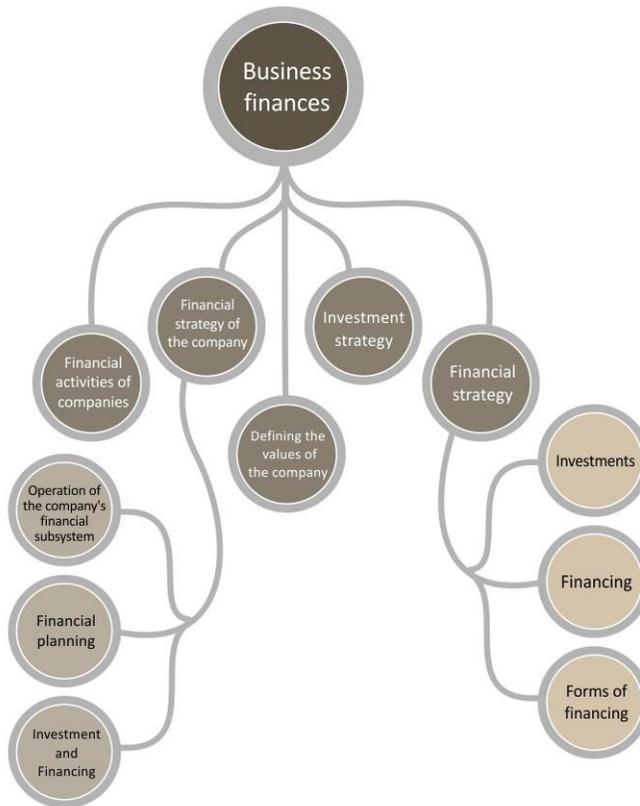
Finances have an important place in the life of a company, money is spent on activities and it is an expression, reward for achievements. The owners invest different amount of capital into different sized and different scope of business ventures (there are many other motivations). However, the common feature is that they want to augment capital, and they wish to realize profit from the operation. Financial condition of the company and the financial ratios are indicators not only for the management, but also for the owners. It indicates the effectiveness and efficiency of the operation. To understand the financial processes it is important for students to:

- know the concept of the company's financial strategy, and its main tasks,
- know the economic value of the company,
- be able to make difference between the types of different investments,
- be aware of the requirements of the funding strategy,
- know the financial operation of the company's subsystem,
- be aware of the functions of the company's accounting subsystem,
- know the concept and role of balance sheet, income statement and cash flows in corporate financial management,
- know the investment and financing methods and basic conditions of their consistency,
- know the issues related to equity and debt financing,
- know the most common forms of financing.

11.2 CURRICULUM

In the lesson we discuss the strategy of the company's financial function, and we observe the external and internal factors. We will have an overview on these factors how they impact on the company's values. We analyze the investment and financial strategies. When examination financial subsystem we are going to discover the functions and parts of the subsystem. In the next chapter integration of the financial plan to corporate strategy will be discussed. We review the mutually defining issue of investment and financing. We analyze the ways, opportunities

and attitudes of own and outer sources. At the end of the lesson we describe the frequently used financing methods according to timeline.



60. Figure: The activities of financial firms

11.2.1 Financial activities of businesses

To create and operate a business capital, money is needed. Finance has a big role in important decisions and in the daily life of companies. After sale of a product and service the reward comes as money, and the acquisition, production, and expenses are expressed in natural measures. The outcome of the activity can be generated as the difference of income and production costs. If this result is positive then it is profit, if negative, it is called loss. The owner of the company invests money (capital) in the company, because he hopes to increase the value of money (wealth). The most common financial goal to increase the value of the company and through it to increase shareholder's value (wealth).

Company finances are several activities in the entire company, successful lead is the task of financial management, they have to plan and realize financial strategy.

11.2.2 Financial strategy of the Company

The financial strategy could be divided into two parts:

- provision of resources required for effective operation.
- efficient allocation of available resources among the investment alternatives for strategy realization

Companies financial strategies involve the following tasks:

1. Decisions on various equipment and liabilities are defined by principles and methods which are set for the whole or for each subdivisions of the company.
2. Plans investment strategy, and capital budget.
3. Defines financial strategy (specifies the resources that can be used for financing operations)

☞ **Financial strategy: Planning and fulfilling investment- and financial decisions the aim of which is to increase value of the company on long term while maintaining acceptable level of risk.**⁹²

In the next 3 subsections the tasks of financial strategy will be exposed.

Factors to determine the value of a company

The knowledge and definition of company values is an important starting point to define efficiency. The content and methodology of valuation is rather subjective because the principles and methods are varied. Subjectivity appears in two variations:

- Value of the company is subjective because it is influenced by possible changes of the future
- Stakeholders of the company evaluate by different techniques as they take various aspects into consideration.

From the viewpoint of investors (owners) the most valuable price dimension is the economic value of the company.

⁹² CHIKÁN, ATTILA: Business economics, AULA Kiadó, Budapest, 2008. 452.p.

📖 **Economic value (market value): The price that investors are willing to pay for owning future gain resulting from the ownership.**⁹³

- ☐ Future gain, benefits contain two components: expected dividend rate and expected future rates of ownership rights embodied in shares.

The economic value of the company depends on internal and external factors:

- The most important external factors
 - expectations on changes of the whole economy in the future
 - industrial forecasts, scenarios, and expectations
 - other external economic and non-economic risks
- The most important internal factors
 - realization of future strategy, consistency, transparency, eg.
 - highly important business political decisions
 - effectiveness of the company's operation, that can be evaluated and planned by different financial indicators

From the side of the investor there are many factors that can influence the value of the company:

- The expectations of the investor formed after the evaluation, survey of the external and internal environment of the venture.
- The investor's time preference: The planned duration of the investment can be an important influencing factor (long-term investors could be part of the strategy management, short-term investor's preferences could be different. (eg.: in case of speculative investments.)
- Other investment alternatives, for example expected bank-government bond interest rates could be an important factor
- ☐ Value of listed companies could be measured after a complex external and internal factor examination in interaction with investor preferences. The indicator is the current price of the shares.

⁹³ CHIKÁN, ATTILA: Business economics, AULA Kiadó, Budapest, 2008. 455.p.

For economic value of the company future expectations have significant impact

Investment strategy

The principle of investment has two meanings at companies:

- outward money deposit of the company (external investment)
- effective allocation of the resources inside the company, the means are ensured for the operation of the company

An investment could be outward or inward the goal is: profit

☞ **Investment: Money deposit to fulfill companies' goals in order to get profit.**

A. Outer investment: The company invests the available money (capital) into another company's operation.

Types:

- **Final:** The company having obtained holding rights wants to realize capital increase or dividend.
- ☐ The company with holding rights can have leading rights in proportion with his investments. If it gains majority then it is a parent-subsidiary connection system.
- **Temporary:** with loan the company intends to acquire interest income.
- ☐ Loaner does not take part in the management of the company. (Money spent is strictly controlled by him - Monitoring)

In the globalised world this form of investment gets more and more international. Parts of free money resources of companies are allocated this way toward demands of capital markets.

B. Inside the company capital allocation: The deposit of the money is inside the company, to grant the resources for the operation. This way the company wants to get profit.

Realization of investments is up to inner and outer interests and activities. In the complicated planning and execution financial management has important role.

Duties:

- conducting financial priorities
- setting up investment alternatives that are useful as discussed at company assessment

At investment assessment it is good to consider the following:

- Expectation of return,
- Risk factors
- Time preference.

This process is involved in the preparation of capital budget of companies.

 **Capital budget: Analysis of long term investment opportunities and choice from them.**⁹⁴

Its elements:

- **Determining expected profitability,**
- **Cash flow analysis,**
- **Taking into account other decision criteria.**

Financial strategy

Condition of investment is that the financial resources are available for implementation. Planning of investments is equal to revealing financial needs. Demands of financial strategy are the following:

- **Security requirements:** can be tackled through the proportion of own and outside capital but there is a difference between risks of various financial resources.
- **Profitability** depends on the costs of the finance and income generating ability of the investment.
- If the value resources and instruments are in harmony then **liquidity and long-term financial stability** is solved at the company.
- **Question of independence:** Independence of company management from loaners, investors. The used resources are "bounds": for example a loaner can limit the use of his loan, or right to vote can influence company decisions.⁹⁵

-  In many situations the principles all together cannot be fulfilled. A profitable investment may result in higher risk and often associated with reduced liquidity. A cheap financial resource is often connected to loss of independency.

The following question can show up in connection with financial strategy:

- - What should be the composition of capital structure, as for the ratio of private and outside sources?

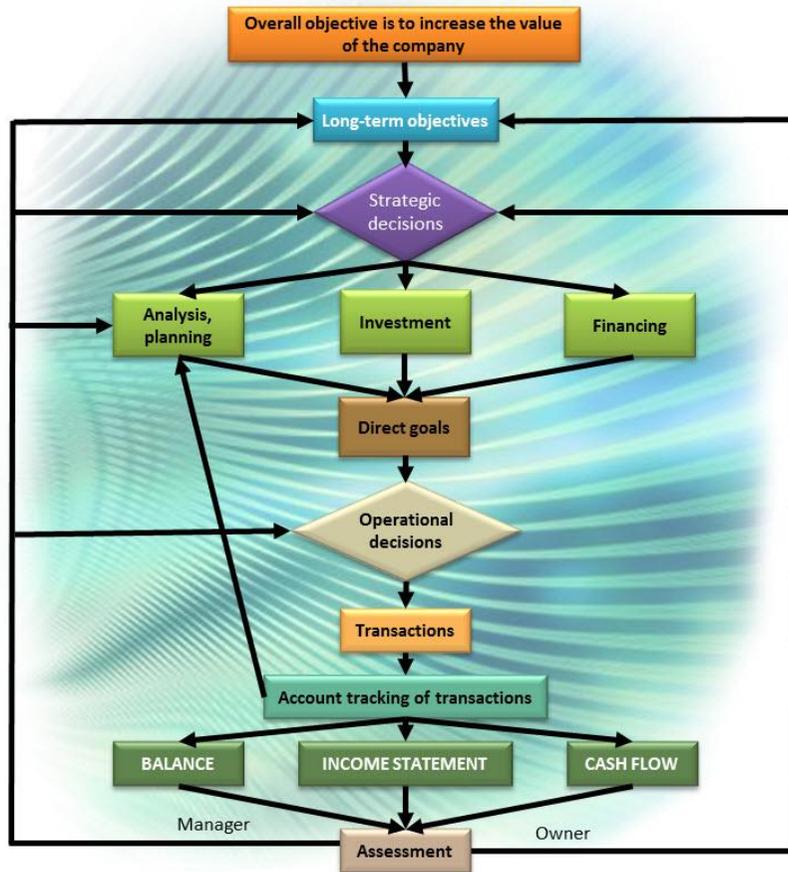
⁹⁴ CHIKÁN, ATTILA: Business Economy, AULA Kiadó, Budapest, 2008. 462.p.

⁹⁵ CHIKÁN, ATTILA: Business Economy, AULA Kiadó, Budapest, 2008. 463.p.

- How to create harmony between resources and utilizations (considering quantity and their evolution over time)?
- What kind of financial forms did the company choose after answering the questions above?

11.2.3 Financial operation of the company's subsystem

The operation of the financial system is shown below:



61. Figure: Operating scheme of a company's financial system⁹⁶

The different transactions are reviewed by the financial subsystem of the company. The data is made after the review, this data is important to

⁹⁶ Source: CHIKÁN, ATTILA: Business Economy, AULA Kiadó, Budapest, 2008. 464.p.

make the financial statement. Three important kinds of the financial statements are:

1. **Asset Report (balance sheet)**
2. **Income statement,**
3. **Cash flow statement**

📖 **Accounting subsystem: An information system about the operation, assets, financial and income statement of the company.**⁹⁷

Accounting examines the company's wealth from two perspectives:

- **From material side:** Assets
- **Basis of origin:** Resources

This is visible in Asset Report, in balance sheet.

📖 **Balance sheet: A two sided asset report. It shows the money value on a given date. It shows the forms of the assets and the financial resources, origins.**⁹⁸

📖 **Assets: Economic resources created in the past and still financing the operation, profitability of the company.**

Groups:

- **Invested assets:** they serve the operation of the company for longer than one year: for example. property, machines, long-term investments etc..

- **Current assets:** they serve the operation of the company for less than one year: for example. stocks, receivables, cash, etc ...

📖 **Sources: Financing source indispensable for operation.**

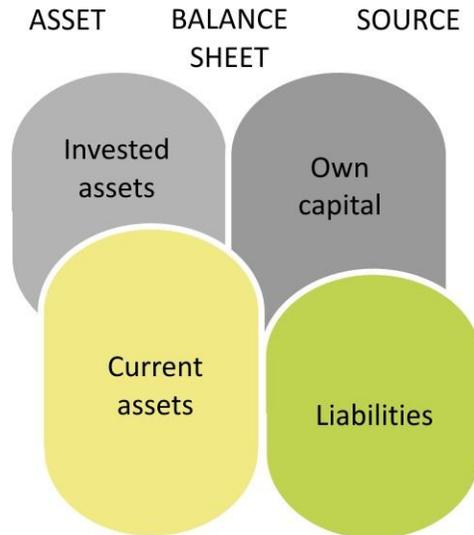
There could be two sources:

- **From the owner (own source):** it has two parts: provided capital portion (capital), reinvested (reserved) profits.

- **From the loaners (outside source):** repayment obligations fall within different time horizons

⁹⁷ Source: HORVÁTH, KATALIN: Accounting in practice, SALDO Rt., 2001., 35. p.

⁹⁸ Source: ÉVA, KATALIN: Accounting analysis I., Perfekt Kiadó, 2007., 51. p.



62. Figure: Scale Structure⁹⁹

- ☞ **Result manifestation:** Contains the accounted income and expenses in a time period. Benefit; the performance is measured by the invested input, disadvantage the counting is not connected to the cash flow then to the finished activities.
- ☞ **Cash flow:** It contains the collation of income and cash outflow in a time period. This is behind the income statement it shows the process with the money.
- 📅 Cash flow control is the most basic task of corporate financial management, regulation of the cash flow creates the financial basis for the company.

Corporate management processes are described above from different perspectives. Among the financial statements there is a close relationship. The result of the same decision could be visible in the financial statement in different ways. Task of the financial function to evaluate, test, plan, exploits, or even compensate the different types of effects.¹⁰⁰

⁹⁹ Source: Based on C. Act of 2000. own graph

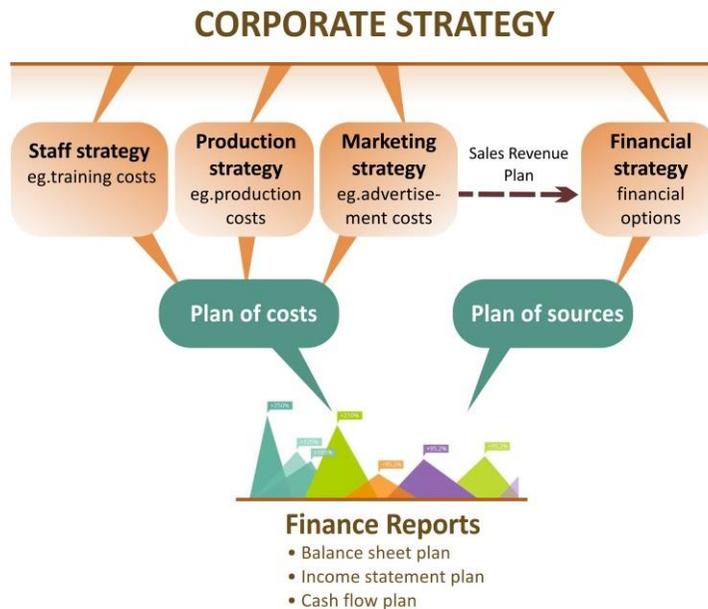
¹⁰⁰ CHIKÁN, ATTILA: Business Economy, Aula Kiadó, 2008. 469-473. p.

11.2.4 Financial planning

The main objective is to create financial statements for the future (planned), this way the company is able to control the strategy from financial perspective and size up potential risks. The starting point of financial planning is corporate strategy. To fulfil certain functional strategies and to succeed in the required activities financial management allocates financial regulations meanwhile they ensure the the timing of activities and financing. This time they state the costs and expenses needs of the certain future activities, then they aggregate these data to the functional areas. The budgets of various functional departments can be formed this way. Parallely with this they develop the funding needs of various functional areas taking influence of the certain activities on profitability and liquidity into account.

- During the calculations the future uncertainties in financial field must be taken into account: for example inflation, impact of foreign exchange rate changes, expected changes in the base interest rate, etc.

If expenses and financial plans are aggregated, cost- resource plan of the total company could be created by which a projected balance sheet, income statement and cash flow statement can be prepared. The following figure shows a simplified image of this process.



63. Figure: The financial plan factors¹⁰¹

- ☐ Careful preparation of such statements and realistic data content can have a significant impact on the corporation and its stakeholders. It could be important and determinative for the investors and on confidence of the investors. Naturally for a company with reliable financial plan it is easier to acquire cheap external resources.

11.2.5 Investment and Financing

The basic function of financial management is to succeed in strategy. The strategy contains investment-related decisions that are necessary for operation. In their decisions they have to deal with founding tasks as well.

- ☐ The two activities are closely related. Profitability of the investment depends on the way of funding and the way of funding effects on profitability.

¹⁰¹ Source: CHIKÁN, ATTILA: Business Economy, AULA Kiadó, 2008., 476. p.

- The time factor also plays a key role in investment and financing decisions, both activities have long-term and short-term implementation periods.

Investments

Long-term and short-term investments can be distinguished based on horizons. Long-term is connected mostly to assets for example: machines, properties, and lasting financial investments (acquisition of other companies) and deposit of current assets for long time. Current assets are mostly stock purchases, operating expenses (eg. overheads, wages, labour costs, etc.). There are many ways of investment assessment the most important of which are where in addition to time value of money also risk factors are taken into account. The asset side of the balance sheet shows the structure of the company's investments.

- **The activities of the company:** In general industrial and agricultural companies, have permanently fixed asset (eg. property, machines and vehicles) and relatively low amount of stocks are held. In case of commercial companies such structure is usually reverse.
- **Applied Technology:** If the company uses modern / new production systems and represent great value for long-term investment while operating costs can be minimized.
- **Size of the company:** Large companies possess bigger capital. For them higher value and more durable tools are available. For small companies this is not really possible.
- **History of the company:** Formerly established companies operate in the industry with specific fixed asset. This is not specific to newly established companies.
- **Size of the market:** Greatly influences what size is economical.
- **Leadership skills:** An incompetent management can create distorted asset structures.
- **Government regulations:** Tax rules primarily affect the structure.
- **State of economy:** an economy in conjuncture stimulates investments, while an economy in recession seeks for labor savings. These factors may lead to quite different asset structures.

Financing

One of the most important tasks of financing policy is to determine the percentage of private-outside sources.

A. **Own source** is the part of the company's capital, which does not have an obligation to repay.

Specifications:

- It may originate from outside (eg, equity issuance) and internal sources (eg, reinvested profits).
- The higher a company's own capital ratio, the greater its financial independence.
- A substantial proportion of equity also makes the company stronger against any crisis. (More equity temporarily compensate for some of the "tight" years' loss as well.)
- For the company's creditors equity also represents safety: The greater the risk of credit surcharge, the smaller the proportion of equity.
- Primary own source is listed capital, which can be increased yearly by retained profit.
- The base capital may be raised by issuing shares additionally.

☞ **Self-financing: If company developments are implemented solely from its own resources.**

Pros:

- Immediately available
- The source has no explicit cost,
- There is no refundable payment obligation
- Increases the company's liquidity.

Cons:

- The companies' growth rate could be limited
- Preserves the existing structures (money is invested in the same area where it arises)
- Decreases ambition for profitability (no need to pay interest after the source, in case of failure already been gained income is the loss).

☞ **Liquidity (ability to pay): It means that the company is able to fulfil payment obligations on time and in order.**

☞ **Ready pay- ability: this means that the company is immediately able to pay in cash or with something. that replaces money. For**

example: for large part of companies in fierce competition self-financing method is not enough so foreign funds have to be involved in order to effectively improve their competitiveness.

B. Outside Source: Part of the company's capital, which has an obligation to be repaid.

Specifications:

- In situations it is indispensable to increase equity by credit: for example new technology changes or conformation to fast market changes.
- Obtain foreign sources is up to the company's current and future income gaining ability.
- It can come from company, financial institution, the state, individuals, institutions.
- The loaner takes smaller or bigger risk (maybe the company is not able to repay it)

Influencing factors of the rate of equity- and outside capital:

- The management want to maintain the independence of the company or not.
- The company's phase of lifecycle can also affect: at early phase mostly external financing (share issue, because due to less capital it is less creditworthy) at mature phase reinvested profits are typical.
- The interest rate of the loan also affects significantly (low-interest loans will ease borrowing).
- The rate of income tax can be a significant influence factor
- Depends on the country's financial and capital market characteristics (financial markets have major role in the US, in Germany banks are more important)

C. Creating harmony for assets and sources

Choosing the method for funding it is good to consider which source covers which asset. According to the rules of asset-source matching (that is horizontal financing rule) fixed assets and long-term current assets are financed from permanent source while assets of return structure are financed from short-term sources. That is expiry structure of sources must be matched to the return structure of the assets. From the view of the company's liquidity it is of key importance that the maturity structure of assets and sources are in harmony. These are constant and specific requirements for financial management. Task of efficient financial management is to have the harmony of the assets and sources and guarantee the liquidity, fast cash turnover (increasing the rotational

speed and use of temporarily free funds). Based on the expected income and costs over time it can be measured and the company can calculate and prepare to the expected liquidity shortages. So efforts can be made to coordinate the inflow and outflow of funds. It reveals lack of efficiency of management if the company has temporary cash shortage or excess liquidity. Shortage in liquidity could be reduced by various measures such as:

- If possible, they defer expenditures of the company for example. slows procurement, later deadline to pay off suppliers, cuts costs back, etc.
- If possible, by bringing forward or increasing revenues they intend to normalize the situation, for example. selling off inventory stock, selling off its storage, etc.
- Under favorable conditions they may involve short-term working capital loan.

Financial forms

The most common short-term sources: (financing needs are within 1 year):

- Short-term bank loan: Obtained on condition that the company's creditworthiness(bonity) is proved. The bank may require some cover from borrowers. The size of the actual interest rate depends on the size of the loan, the amount of credit used, the maturity of the loan and other costs, for example. commissions.
- Commercial loan: Provided by the supplier to the customer, payment obligation arises later. The size of the interest rate, term of the loan is subject to a mutual agreement.
- Overdraft: Commercial banks, where the company has its current account, may allow companies account go red.

The most common source of medium-term financing (for a period of 1-3 years):

- Mid-term cash loan (bank loan): The bank may require additional guarantees compared to short-term credit.
- Leasing - is a special financial form where lessor can buy the leasing object (named by the lessee) if the lessee has used it for specified time. In the lease agreement there is a fixed time to pay fee by the lessee, this is lease payment. The collateral of the lease agreement is the subject of the lease itself. The lessee can

have the ownership at the end of the financing term as well as after the payment of the total lease, after the so called residual value is paid.

Long-term financing (over 3 years):

- Shares: The sale and issue is performed mostly at the stock market. Benefits: no fixed cost (interest rate) over the expense of the issue, no expiration date, you do not have to pay back, increases the company's capital and thus creditworthiness. The disadvantage may be the change in ownership structure.
- Bonds: registered securities, debt. The issuer (the debtor) undertakes that a specified amount of money, interest rates, commissions will be paid to the entitled in the indicated time and manner.

11.3 SUMMARY AND QUESTIONS

11.3.1 Summary

The goal of financial strategy is that investments and financial decisions are fulfilled in the way that value of the company will increase in long-term. Value of the company could be influenced by internal and external factors, the ones which influence the future are the most important. Definition of investments has two viewpoints external investment or internal allocation, opportunity for long-term achievements is analyzed in the capital budget. Financial strategy and investments rely on each other mutually. Accounting subsystem provides the most important information on financial planning. The three most important statements are: the balance sheet, income statement and cash flow. Financial plan shows expected income and financial plan in the life of the company's future. Financing arrangements are private and outside sources used with different utilization rates. Smooth operation from financial aspects is assured by liquidity. For companies, a number of external funding methods are available in different time horizons.

11.3.2 Self -Check Questions

Explain the concept of the company's financial strategy and main tasks!

Define the concept of economic value, as well as the determining internal and external factors!

Explain the concept of investment and interpret the different opportunities!

Describe the main requirements of funding strategy!

Explain the concept of the company's accounting subsystem and characterize its components!

Describe the steps and main objectives of financial planning process!

Determine what factors influence the structure of a company's investments!

Identify the major policy issues of funding and ways of achievement!

Describe the main factors that affect equity and outside capital of the company!

Describe the main sources of financing according to time horizon!

11.3.3 Practice Tests

1 On company's economic value the value of economic assets have the biggest impact. FALSE

2 Fixed assets serve a business operation within one year (short term): eg. inventories, receivables, cash. FALSE

3 The asset side of the balance sheet shows the structure of the company's investments. TRUE

4 Own source is the part of the company's capital, which do not have obligation to be repaid. RIGHT

5 Acquisition of foreign source in capital market is up to current and future income generating capacity of the company. TRUE

6 Commercial loans are given by commercial banks to companies. FALSE

7 Shares are the tools of long-term financing, their maturity is usually 5 years. FALSE

12. CORPORATE STRATEGY MANAGEMENT

12.1 OBJECTIVES AND COMPETENCIES

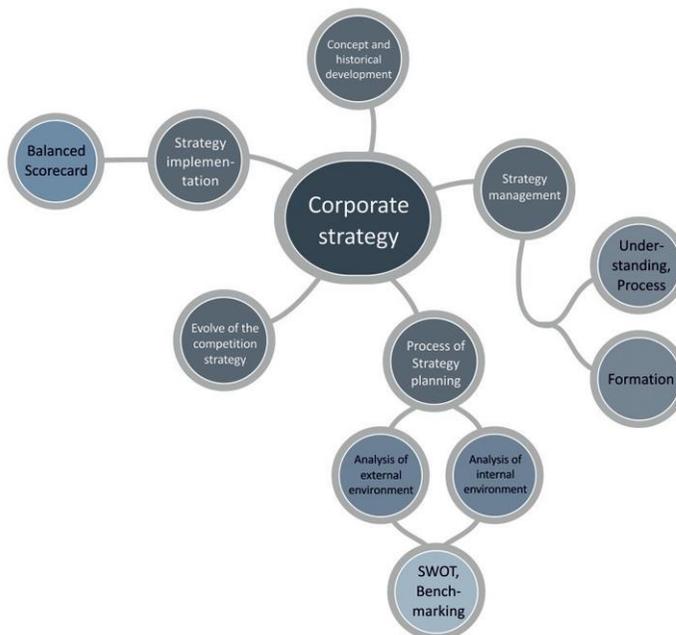
Strategy is the guiding principle of company operation, serves as a kind of guidance to the company's mission to achieve the targets. The goal of the unit is to discuss and share the knowledge of the issue.

Therefore students must

- Be familiar with the concept and the development of strategy and stages of development,
- Be familiar with the process of strategy management and stages
- Must be able to distinguish the levels of strategy making
- Be familiar with the external elements of strategy development and its methods of analysis (BCG matrix, Porter's competitive forces model)
- Be familiar with internal environment analysis: resource analysis, value chain analysis
- Be familiar with SWOT analysis
- Be familiar with benchmarking and with the types of it
- Be able to make difference between Porter's competition strategies
- Be familiar with 8S and BSc concepts, aspects

12.1.1 Curriculum

In the first part we look through the development of corporate strategy and stages of development then process of strategy management and its stages will be discussed. We will distinguish the levels of strategy making from corporate, divisional and functional points of view. We start the process of strategy making with external environment where two well-known methods will be detailed (BCG matrix, model of Porter's competitive force). We are going to analyze the internal key competencies of companies with Porter's model. Internal (strengths and weaknesses) and external (opportunities-hazards) will be presented by SWOT method. Benchmarking is a good option for companies to position themselves in different dimensions or real position, status. The special view and complexity of strategy realization will be represented by 8S model. Balanced Scorecard is an effective method by which the result of the implementation of the strategy can be monitored and assessed.



64. Figure: Corporate strategy

12.1.2 Historical development and concept of strategy

The expression of strategy could be more than 2000years old. The ancient Greeks realized that the chance to win a battle could be better if:

- the goals are specified
- they plan the methods of realization
- they define and upgrade the type, quality and quantity of resources

The army and the leaders - the strategoses - developed and implemented the ideas that are called strategy. From the perspective of history strategy is not more than the art of military command. In the last century due to external and internal influences companies were forced to change their strategy. Now they have similar principles, methods, procedures to the ones in the military. In business life strategy defines the processes, alternatives, valuations that can lead to achieving the goals. There are several definitions of strategy, such as the following:

„ Strategy is a way to follow, to reach a mission, a vision and goals. It involves what to do and the

*strategic decisions that are required to achieve a given goal.*¹⁰²

*„The guiding principle of business operations, defines business goals and ways how to achieve them..”*¹⁰³

*„Strategy is a long-term direction and operating area for a company, combines resources, satisfies market demands, and meets shareholders' expectations while providing benefits in a changing environment.”*¹⁰⁴

Historical development of strategy in business sector

In the last century future planning was only informal, this means corporal plan was only inside the heads of corporate leaders. At that time it was not necessary to look at the future. In the 1930-ies the biggest American and west-European companies started to formulate plans, they started to document them. Corporate sizes started to grow, activities started to expand and competition on the market started to get intense.

A. Period of financial planning (.....-1955)

After World War II because economic, social, and environmental changes it was difficult to create ideas and coordinate plans. Formalized planning appears in enterprises in the 1950-ies in West-Europe and in the US. This system was operative (max. 1 year time horizon), and was characterized by unilateralism. Formal planning was useful to show financial indicators. The start point for every process was last year's data. This way they were able to define sales, production, procurement finance processes. This method produced the next year's revenue, cash flow plan and balance plan. The short-term approach, and the narrow dimension of planning was not conducive to development.

B. Period of long-term planning (1955-1970)

Due to reconstruction significant capacity had been built, which laid foundations to economic recovery. The economic boom with low inflation and high employment was accompanied with increasing income,

¹⁰² BARAKONYI, KÁROLY: Strategy planning, Nemzeti Tankönyvkiadó, Budapest, 1999., 21. p.

¹⁰³ CHIKÁN, ATTILA: Business Economy, AULA Kiadó, Budapest, 2008., 187.p.

¹⁰⁴ GERRY, JOHNSON – SHOLES, KEVAN: Exploring Corporate Strategy, Prentice Hall, New York etc., 1997., 10. p.

continuously and predictably increased demand. The relatively long-term economic growth allowed companies long-term planning. Partial perspective was replaced by comprehensive view involving the whole company. First there was sales planning then production planning finally it was by the determination of the optimum level of resources. Typically used methods were trend and regression calculation.

C. Period of strategic planning (1970-1980)

At the end of the 60s development in developed countries got slowed, and what is more, in the early 1970s it was replaced by recession. At the beginning of the period, companies had significant overcapacity. Difficulties in sales, increase in costs (oil price boom) resulted in increased market competition, so they had to watch out for external factors. Companies often used the following countermeasures:

Their activity was increasingly diversified to other industries and utilization of the possibilities of tertiary sector came foreground.

- Instead of formerly dominant production function increasingly important role was given to research and development, marketing. Qualitative approach and cost management came to the front as well.
- Companies started to use IT, making processing, analysis of information more efficient.
- New expectations to society and movements emerged against the corporate sector: eg. environmental protection, consumer protection, etc, so these aspects also increasingly had to be considered in planning.

The methods used before did not meet the expectations in the uncertain environment so in the planning process new principles and methods emerged:

- Strategy planning had new portfolio models: for example BCG-matrix, GE-matrix, SWOT analysis and product life cycle model.
- To design the so-called strategic actions, scenario models were used, several plans were created for various eventuality, and also probability of the fulfilment of the scenario was considered taking possible risk factors into consideration.

D. Strategic Management (1980-

At the beginning of the period, thanks to the powerful wave of privatization, spread of multinational firms got significant. Thus domestic

companies had strong and great competitors. Environmental factors were changing fast, there were a lot of uncertain factors. In the previous periods company's strengths were utilized to respond to environmental challenges, this aspect did not consider important dynamization of the whole organization. Therefore planning was the task of the planning department and strategy was not integrated into the life of the company. The change in the approach to strategy was resolved by re-interpretation so in the development of strategy all subsystems have to take part. The new processes must be lead and coordinated by new functions this is strategy management. Strategy development has changed: the analysis of the construction of the industry has got important, also mapping of competitiveness and competitive advantages, as well as distinctive strategies. Expanded, perfected strategic analysis methods were created: Porter's industry-and competition analysis, value chain analysis. In the implementation of the strategy, the following played an increasingly important role: stakeholders of the company, corporate culture and organizational structure. In the early 1990s, the disintegration of the socialist system opened new resources and new markets for companies, however, the changes are even more unpredictable. Developments in information technology, the Internet completely re-arranged the industries. New communication technologies have no borders, there are no spatial and temporal constraints, globalization accelerates. Many industries are promoting strategic partnerships in various forms instead of fierce competition, number of corporate mergers have increased. A more strategic approach with new elements has emerged: companies tend to build strategies to exploit their special abilities, spread of the TQM approach, balanced scorecard methodology is significant. Organizations become horizontal, decentralized. To improve the operation they redesign their business process and BPR appears.

Further rearrangements occur at the beginning of the 21st century: the 2008 financial crisis leads to radical, hectic and high-speed changes. Though with economic downturn, globalization continues, the number of bankruptcies grow. Nowadays competition is information and knowledge-based. Relations between the company and its stakeholders are increasingly important. New strategic approaches occur: change management, knowledge management and creative methods, etc.

12.1.3 Strategic Management

At the end of the 1970-ies strategic planning was criticized by theoretical and practical experts. They point out that the system was bureaucratized and creative thinking was ridden. In that period environmental changes were fast. The system they used was not good

any more to place it in a broader context in which the whole company was involved.

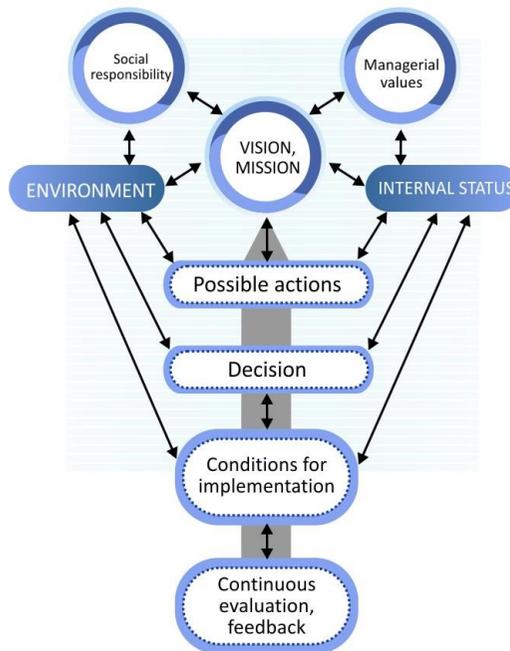
The interpretation of strategic management, process

„ Strategic planning is management based on the combination of strategy implementation and feedback.”¹⁰⁵

Process of strategic management has the following sections:

1. **Strategic planning**, its components are analysis, developing action plans, decision.
2. **Strategy realization**, practicability is an important point of view.
3. **Continuous evaluation, feedback**, which emphasizes the cyclic nature of the process.

In the following subsections the topic is discussed according to these sections.



65. Figure: Process of strategic management¹⁰⁶

¹⁰⁵ CHIKÁN, ATTILA: Business Economy, AULA Kiadó, Budapest, 2008., 506.p.

The most important general issues related to the development of strategy

Before the company begins to implement the phases of strategy management they must answer the following key questions:

- A. How should strategy development be created inside the company? Which phases should take part in it?
B. What is the task of internal stakeholders in strategy development?
C. What is the time length of strategy development?

A. Levels of strategy development

In traditional interpretation strategy has 3 levels. These levels have their own managers.

a) Corporate level strategy

- Includes the goals of the company, the important changes in business branches, main tasks of functional strategy.
- Important task is allocation of resources among the business branches, and control to create all-company efficiency (creating all-company portfolio).
- Senior management has key role in strategy development.

b) Business branch level strategy

- Includes the goals of the strategic business units (SBU) and combination of the methods and necessary resources.
- As SBU has more than one product line, the strategy includes plans for the product portfolio, too.
- Business branch managers, division managers have the key role in strategy development.

☞ **Strategic Business Units: distinct business units within the company, which represent well-defined product-market combinations, their competitive position and effectiveness can be assessed on their own.**

Its four important features:

- An independent professional unit within the company
- Its performance can be independently assessed and judged
- Well defined environmental conditions (customer demand, competition etc)
- Can be isolated from the company, but has company- related strategy

c) Functional strategies

¹⁰⁶ Source: CSATH, MAGDOLNA: Strategy planning and leading in the 21th century, Nemzeti Tankönyvkiadó, Budapest, 2004., 41.p.

- Specified goals, methods and assets, for example R&D, marketing, innovation, HRM, finance, production, sales etc. related to the various functional areas of the company are included.
 - Key to effective implementation of functional strategies is that they develop principles of cooperation and coordination between the various functional areas (Attention must be paid to interdependence of each functional unit)
- ☐ The next chapters deal with strategic planning, implementation and evaluation processes related to business branch level strategies.

B. Relationship of internal stakeholders with company strategy

The relationship is the following:

- The main task of the senior management is development and evaluation of corporate and divisional strategic concepts
- Owners have an important role in decision making between the alternatives.
- Mid-level managers are involved in detailed elaboration of the strategy.
- Low-level managers and employees play a decisive role in implementing the strategy.

C. Time horizon of the strategy

Generally accepted time horizon was five years when strategies were developed by companies. But this method was inappropriate, for some industrial branches the time bound caused difficulties. Connection to the duration of product and technology life cycles was a new start point. The time horizon should be defined by the business branches. In some cases it is 5-10 years, while in other cases it is only 2-3 years. Decision making about time horizon could be influenced by internal and external factors. There are ones who believe, a company has a lot of actions going on at the same time in parallel for example investment, the introduction of new product lines, new markets, the implementation of innovations -, so time horizon should be adapted to the implementation that requires the longest time. Overall, general formula to the problem cannot be given. The best solution to all companies is that internal and external conditions are taken into account at decision making.

12.1.4 Strategic Planning Process

It has two action lines: strategic analysis and strategy formulation, which ends in decision. During the strategic analysis the company first evaluates external environment (macro and micro environment) taking

into account terms of the social responsibility, the needs of external stakeholders. Then the next step is evaluation of internal environment taking into account managerial values. After the analysis the company determines the vision, mission and after different perspectives it develops strategic action plans, which end in a decision.

Analysis of the external environment and social responsibility

The company identifies and analyzes the key elements affecting external environment which should start first with macro environment components then it goes on testing the direct (market) environment to get a whole picture about the status of the environment and possible changes in future trends. In the 21th century, there are stronger expectations of society towards companies so that their activities have minimal negative effects of certain social, economic and environmental spheres. **The analysis of external environment generally consists of the following sub-processes:**

- collecting information,
- analysis and evaluation,
- making forecasts
- comparison of the strategic plan and forecasts.

A. During the test of macro environment, the following should be analyzed:

- Political factors: political parties and their role in political stability, government involvement in economy, rate of democracy, corruption, etc.
- Economic factors: GDP, inflation, unemployment, interest rates, wages, energy prices, exchange rates, infrastructure characteristics, etc.
- Legal factors: law and legal certainty, justice, competition law, labour law, tax law, etc.
- Socio-cultural factors: values, social norms and business ethics, entrepreneurship, demographics, healthcare status, etc.
- Knowledge and technological factors: the degree of R & D, the role of technological transfer speed, ICT development, education level, number of researchers, the quality of higher education, the proportion of high-tech exports, etc

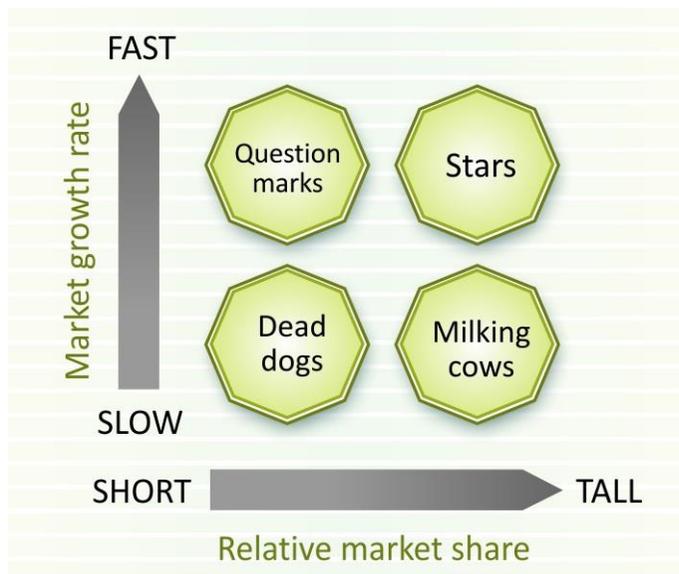
Priorities can be assigned knowing the corporate capabilities.

B. Microenvironment analysis is an analysis on the company's competition environment. This area also can have a lot of members, who in addition - the same way as the company in question – have elements of macro-environment impact on. A number of techniques exist to

examine the company's competition environment but the most popular ones are: portfolio methods, and Porter's five competitive-forces model.

a) In portfolio analysis the company's products (services), product groups, and various business units are compared to some aspects of external environment options. The best known form is BCG matrix.

- ☞ **BCG matrix method is named after the organization (Boston Consulting Group). The relative market share of a specific product, product group, business unit (as compared to the strongest competitor) is compared to their market growth rate. The 2 × 2 matrix identifies four groups that promote the development of strategic directions.**



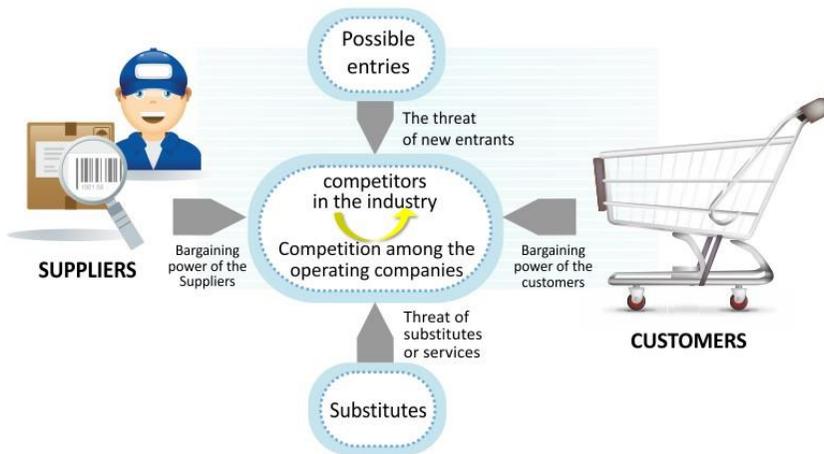
66. Figure: BCG matrix elements¹⁰⁷

- **Question marks** are relatively new products / product groups that currently have low sale numbers, but presumably interest is increasing in them in the future. They require investment which may have risk, but if the service becomes " a star" it can pay off fairly.

¹⁰⁷ CSATH, MAGDOLNA: Strategy planning and leading a XXI: században, Nemzeti Tankönyvkiadó, Budapest, 2004., 108.p.

- **Stars** are the products / product groups that are currently the most sought, on which considerable resources are devoted, but they are useful and popular with the customers, and this is expected to remain so for some time.
- **Milking cows** are the products / product groups, which have high market shares, but interest in them is no longer to be increased. It is not necessary to invest any more into their development, but the level of service provision must be provided. The prestige, satisfaction they have achieved, should be used for the introduction of new products.
- **Dead dogs** are the products / services in case of which neither their market share nor the growth opportunity is satisfactory. They no longer contribute to growth, so their redundancies are inevitable.
- b) Porter's competitive forces model: An analytical method, which defines in a particular industry the key structural factors. It has direct impact on competition factors and therefore on the profitability of the industry. The purpose of creating Strategic Business Unit -SBU competitive strategy is to find a position in a given industry, which the best placed to defend himself or he has the ability to shape the factors for himself..¹⁰⁸

¹⁰⁸ PORTER, MICHAEL E.: Competitionstrategy, Akadémiai Kiadó, Budapest, 2006., 29.p.



67. Figure: Porter's competitive forces model¹⁰⁹

Elements of Porter's model:

Possible entrants are those industries where potential profit is above-average, and this attracts investors. When entering the market in addition to the already mentioned state regulations, other factors may cause difficulties as well, such as:

- The size of capital investment required (eg. Oil industry, automotive, etc)
- Scale of economy (eg. Automotive, etc)
- cost advantages (cheaply acquired sites, real estate, etc)
- Product differentiation (the competition's known brand name, customer loyalty, may cause major difficulties for new entrants)
- access to distribution channels (the distribution deals with proven products, strong selling chains request significant amounts to be enlisted, for providing shelf space).

Substitute products: the size of the potential profit is greatly affected by the price that buyers are willing to pay. If a market has very similar products, after a slight price increase customers can change to the competition. The degree of substitution depends on two factors:

- Sales (brand) loyalty rate.

¹⁰⁹ Source: PORTER, MICHAEL E.: Competitionstrategy, Akadémiai Kiadó, Budapest, 2006., 30.p.

- What is the price of the replacement, compared to the quality and what is the price of the usual product, compared to quality?

Competitors on the market: Competition can occur in several dimensions between the companies that are already there: price competition, marketing, competition, innovation competition, etc. The intensity of competition in the market is measured by concentration of the market. The degree of concentration is given by the number of competitors and the relative market share ratio. The higher the concentration is, the fewer companies cover the market. The intensity of competition on the market depends on the degree of unutilized capacities. If it is large, there is fierce competition among the companies.

Bargain position of the suppliers: bargain power of suppliers is influenced by several factors, such as .:

- Relative size of the suppliers compared to the manufacturers: if the suppliers are small and have undifferentiated products then their bargain power is small. If they cooperate with each other, or there are only a few suppliers, or their inputs are differentiated then they have significant bargain power.
- Suppliers of special quality, unique products can also negotiate from a position of strength with manufacturers.
- Characteristics of supply chain integration also play a big role. With integration in advance suppliers can break into the market, or manufacturers can integrate themselves to the supplier market. The last one, of course, will weaken the bargain power of suppliers.

Bargain position of the customers: Customers in a particular industry force down prices, expect better quality, and more related services. A customer group is strong if they have the following conditions:

- buy concentrated or large quantities compared to total sales (ie. Multi-national retail chains as customers)
- the products are undifferentiated, or substantially standardized (more substitution possibilities)
- vertical integration threats of customers (eg. Spar's own slaughterhouse)
- the customer is fully informed

□ The basic philosophy of Porter's model, which was named after him in the 1980s, is to assume that there is a competition between players of the market. Starting from the 1990s, in many

industries there was a need for stronger integration between the participants, so the role of competition was taken over by various forms of cooperation. The industry's competitive rivalry among the companies is shifting to higher levels, and takes place between various strategic alliances.

The other major change that began in the last decades, and today is becoming more and more important is strengthening of the concept of corporate social responsibility. In the 21th century, there are stronger expectations of stakeholders towards companies.¹¹⁰ The main areas of CSR concerning the company's external environment are the following activities:

- **Related to customers:** The company does not produce harmful products, does not use deceptive, misleading advertisements and does not support socially harmful consumer habits.
- **Related to the environment:** Does not pollute the environment, no harmful substances, no waste, no noise. It does not transform the environment aesthetically.
- **Related to suppliers:** It does not exploit suppliers, does not force them to harsh competition, has fair business relationships with them.

By comprehensive analysis of the external environment, the company can formulate **potential opportunities** that may promise success, can map the **potential hazards** which they should avoid in the future, or important to suppress the effects.

Internal analysis and values of leadership

The first step to analyze internal environment of the company is to create a "resource inventory" and to examine how to match these "hard" and "soft" factors to each other for efficient operation. This method highly depends on management capabilities, methods. Analysis of internal environment defines the company's strengths factors, which can build competitiveness in the industry. During the analysis the company can identify weaknesses which may cause competitive disadvantages in the future, so they can make plans to overcome them, as well.

A. Analysis of resources

The company's resources (concrete), can be classified into tangible and abstract categories. Measurement of the two groups needs different

¹¹⁰ CSR-conception can be found in the 5th chapter.

methods. The first ones are easier to enumerate, the company's financial and accounting documents can be used. In the last decades in the harsh competition there are new factors, these are based on specific abilities (difficult to replicate, copy) that ensure in long term, permanently effective participation in the industry competition.

📖 **Tangible resources: This group includes a variety of machinery, equipment, buildings, technology, financial resources, labor, patents and innovations.**

Their evaluation method has three different aspects:

- The quantity and quality of the resources compared to the competitors
- How to use effectively these resources in the current operation?
- Could the resources be used better way if the company produced anything else?

📖 **Abstract resources: Resources that are usually tied to tangible resources and mean a special ability (competence) for the company.**

📖 **Competence: a set of special abilities, which include: knowledge, experience, and combinations of other special features. They can be divided into two groups:**

- **Key competences** those which present success of the company
- **Distinctive competencies** are what the company's competitors do not possess so far, that is "hidden competitive advantages."

These skills are often developed from the following combinations of characteristics, elements:

- Professionals with special skills,
- Flexible organization,
- Creativity, promotion of entrepreneurship within the company,
- Dedicated employees,
- The company's reputation,
- With suppliers, customers, partners, based on mutual benefits and long-term relationships,
- Customer loyalty to the company's products, services.

If the company's key competences and distinctive competencies overlap then the company can expect long-term success. An important task is that the company continues to develop competencies, particularly

those that reinforce the distinctive character. A competitive advantage is based on more specific competencies, that is more difficult to copy, this way long-term success is granted. The hotbed for formation specific competencies is **corporate culture**.

☞ **Corporate culture: Adopted by the members of the organization, commonly accepted and interpreted system of assumptions, values, beliefs, behaviors, norms of coexistence.**

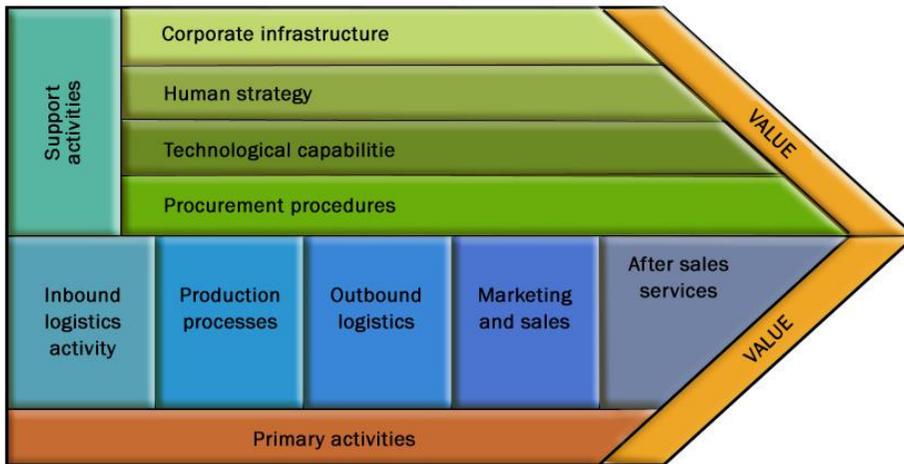
To tackle external environment challenges and internal integration problems each organization develops a behavior that is only characteristic for them. (system of behaviors, norms, values). If it is found - and proven to be successful - this confirms the behavior and the values behind them: the organization will strongly stick to it.

B. Value chain analysis

During the analysis of the resources it is hard to tell about a particular product in the manufacture process which are factors that represent added values. The specific activity of corporate competitiveness not only manifested in the size and quality of the resources but how these factors are connected. A company's distinctive competence may also be revealed that the general resources in the industry are combined in unusual way than others so this way they achieve competitive advantage

☞ **Value Chain: Contains interlinked processes inside and outside the company, along which value represented in a final product / services is created.**

The value creation occurs in a not random activities (resource uses) it is characterized by conscious series of linear and subordination processes that create a socially accepted value. It is named **Porter value chain analysis**.



68. Figure: Model of Porter's value chain analysis ¹¹¹

Elements of Porter's value chain:

Primary activities: Activities that are closely connected to the product/ service production and delivery to the customer.

- Inbound logistics: Inputs of the delivery of services. raw materials, semi-finished products, finished products, etc.
- Outbound logistics activities: Activities in which the product reaches customers.
- Marketing and Sales: The activities in which products / services are acquainted with the customers, and they have access to the product / service.
- After-sales service: Home delivery, warranty services, providing parts supply, service, customer service, etc.

Support activities: support group of the primary processes.

- Infrastructure: This includes the planning and decision-making processes and control systems, information and communication systems, financial systems, organizational structure, corporate culture, etc.

¹¹¹ Source: CSATH, MAGDOLNA: Strategy planning and leading in the 21th century, Nemzeti Tankönyvkiadó, Budapest, 2004., 134.p.

- Human Strategy: Processes related to the organization's human resources.
- Technological Capabilities: Technical procedures, research and development, process management, etc.
- Purchasing Procedures: The process in which the input gets to the company.

The analysis of the value chain can provide a number of opportunities, which the company can build a competitive advantage on eg .:

- Specific departments work together efficiently, for example. R & D, production, in case of sales.
- Vertical integration: The company extends the value chain so it will be more competitive. Eg. A production company buys up a sales network.
- Application of quality-oriented management philosophy (TQM)
- Pursuit strategic cooperation, etc

The company's internal situation and development, combining of these components, and the influence of external factors have a significant influence on the internal value system that is which is mainly represented by company management. At different levels of the organization active managers can have a very important catalytic role to develop the company's resources, create new durable and distinctive competencies, taking into account the supportive interests of external and internal stakeholders. Then a corporate culture is created and the company is not only from economic, but also from society's view functions successfully. These leadership methods can be the following:

- Future imaging, motivation, commitment,
- Co-operation and team building,
- Communications,
- Culture building,
- Delegation of authority.

C. Environmental- internal analysis and summary of the results: the SWOT analysis

Through a comprehensive analysis of the external environment, the company is able to identify the context in which opportunities arise for the future, or, on the contrary, able to identify the potential dangers. Comprehensive analysis of the internal environment of the company is able to determine the strengths and weaknesses, the procedure, in which

the organization finds the correlations and organizes a single structure. It is called a SWOT analysis.

- ☞ **SWOT analysis: The company's strengths and weaknesses and the opportunities and threats summarized and analyzed.**

D. Benchmarking

After discovering the external and internal factors it is expedient for the company to put his products, processes, the business parts and even the whole company in the right position. Benchmarking is a general comparison that includes the company's own and others critical assessment and this way the organization can improve.

- ☞ **Benchmarking: permanent and continuous search for significantly better solutions to improve competitiveness.**¹¹²

Types:

- **Internal benchmarking** is a comparison of the features within the organization. The most common is at companies with many departments, or international companies. The data is easily available and expected to have accurate data.
- **Competitive benchmarking** when products or services are measured when compared directly to rivals. It may be difficult to obtain the relevant information, but the result is valuable.
- **Functional benchmarking** here there is no need to limit to direct competitors. A narrow field of view could be a possible cause of failure. Functional matching examines leading companies in various industries. It defines the performance characteristics that are similar to the functions of the company in question.
- **General benchmarking** the clearest way of overall measurement methods, which have not been used so far in their own industry. Overall measurement extends functional measurements by removing the barriers which restrict the study of similar characteristics.
- Benchmarking is fundamentally different in 3-points from complete analysis, for example. from SWOT:

¹¹² CAMP, ROBERT C.: Business process Benchmarking, Műszaki Tankönyvkiadó, Budapest, 1998.

- Benchmarking is not necessarily a competitive analysis, it may be comparison to the best neutral industries.
- Benchmarking is process-oriented: the value creation process is handled in a complex way.
- Benchmarking is always compared to the best: encourages **long term** awareness, foresight and planning.

12.1.5 Competitive strategy planning - possible actions

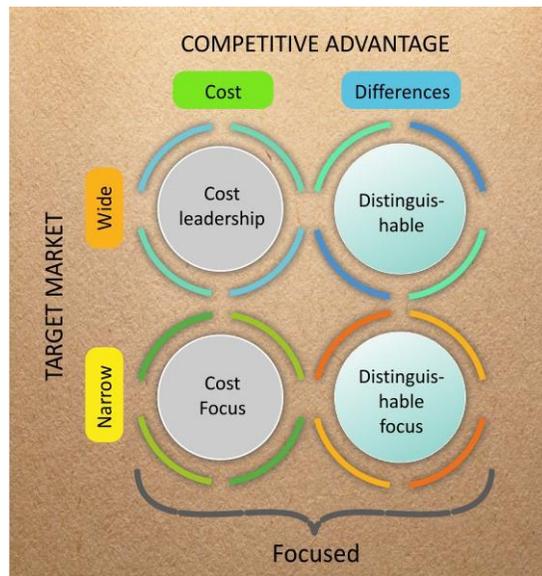
In literature solution can be found, perspectives for organizing different strategy types. Now we take Porter's competitive strategy principle.

According to Porter's competitive strategies

Porter's approach recognizes that every strategy in the market is competition strategy, the main task of strategic management is to ensure long-term competitive advantage. There are two basic choices to gain competitive advantage:

- If the company produces so cheap, that consumers can get a **favourable price**.
- If there are specific characteristics of the product, which can meet the special needs of a group of buyers. In this case their **competitive advantage is based on the uniqueness or distinction**.

Porter connects this division with a point of view, that how big the size of the target market is where the company wants to get competitive advantage. The basic strategies illustrated in 2 × 2 matrix:



69. Figure: Basic competitive strategy (according to Porter)¹¹³

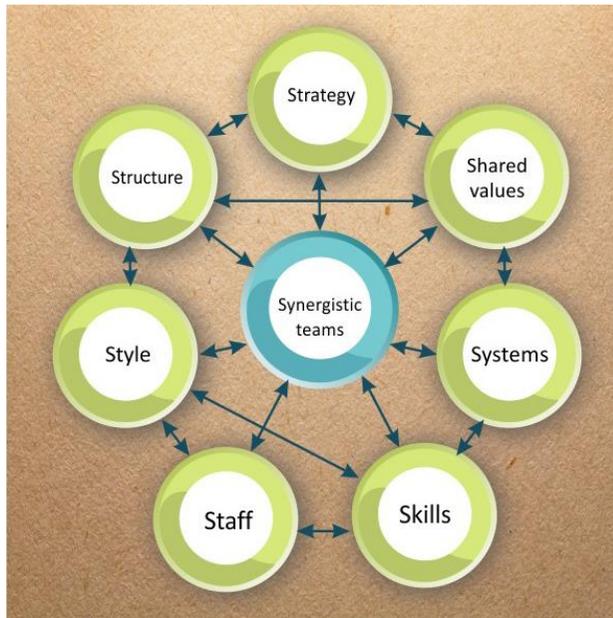
- **Cost Leader Strategy** Due to low cost there is quite high market share (high turnover, low specific benefit) or if it is offered at the same price the specific yield will be higher.
- **Distinctive strategy** the product is unique by a characteristic feature considered important by customers, and so they are willing to pay a premium for it. Distinction is based on a wide variety of possibilities (the quality of goods or services, surplus services with the goods, reliability of demand satisfaction, speed, etc.).
- **Concentrating strategy** in this case the focus is on a specific segment or segments of the market. Competitive advantage is built on strength for low costs, or for uniqueness. The most important is that the company can adapt effectively to a particular market segment, in this segment company should use one of the competitive advantage or organizational strategy. Apart from the choice of competitive strategy it is also necessary that the company chooses from among the possible combinations of strategic resources. The company needs different competencies, skills to achieve individual strategic alternatives. Whichever strategy the company may choose, it will only be effective if the

¹¹³ Source: CHIKÁN, ATTILA: Business Economy, AULA Kiadó, Budapest, 2008., 519.p.

gained competitive advantage is sustainable the longest possible time.. This requires that the company builds its ability on a competitive advantage that is not easy for competitors in short term to copy. Last but not least, evaluation of the strategies should be made if it fits to the organization, concerning the expected acceptance, the attitude of the internal stakeholders. Expected level of organizational resistance (which can kill any good alternatives), and potential opportunities for promotion are the subject of the analysis in this field.

12.1.6 Implementation of the strategy

Strategic management includes strategic planning and joint process implementation. The successful implementation of strategic plans has many conditions. 7S model, developed by the consulting firm McKinsey and the extended 8S-model represent the factors that are essential for successful implementation. Successful implementation of the actions, the results are ensured by constant renewal, learning and new ideas. However, to achieve it good professionals, and professionals with decision-making powers are needed (delegation). Instead of authoritarian, centralized management methods democratic leadership, mentoring skills validation, and genuine teamwork is desirable. This is the condition of successful implementation of the actions and changes as well.



70. Figure: 8S-model structure¹¹⁴

The 8S concept consists of the coordinated ensemble of the following elements:

1. Strategy: combination of strategic actions which helps to achieve the vision.

2. Structure: combination of organizational structure and jobs.

3. Systems: a combination of formal and informal processes operating in the organization, decision making, monitoring, evaluation and communication systems.

4. Style: represented by the behavior of internal stakeholders.

5. Shared Value: common values that stakeholders are proud of, and what they would like to be proud of, in which are successful and are afraid of.

6. Staff: includes all employee knowledge, experience and commitment.

7. Skills: all the capabilities, strengths, skills, quality and quantity of available resources.

8. Synergistic Team: Creating and running a real team effort to integrate the other elements for a successful strategy.

¹¹⁴ Source: CSATH, MAGDOLNA: Strategy planning and leading in the 20th century, Nemzeti Tankönyvkiadó, Budapest, 2004., 217.p.

Continuous assessment of strategy plus feedback

" Each plan is worth as much as you can implement from it " as one common phrase says. Monitoring implementation of strategic plans until the 1990s was almost exclusively based on data from the company's financial accounting system. However, business environment and nature of the resources used constantly has transformed.

„Financial ratios provide a picture about the results of the past few actions, but not able to give guidance for the company what to do today and tomorrow in order to create future financial value. The financial indicators are not able to show values created or destroyed in the previous period ”¹¹⁵

Traditional financial evaluation has many disadvantages:

- Financial indicators measure the effectiveness of the process, rather than connect to strategy .
- In turbulently changing environment financial indicators do not provide realistic results.
- The basic resources for the implementation of strategy are often financial indicators that are not measurable by financial indicators.
- Data from financial indicators are mostly information for owners.
- It does not encourage the formulation of new initiatives and goals.
- No support for organizational learning and innovation.
- It has a retrospective point of view and does not point for guide points.

A. Concept and structure of Balanced Scorecard

In 1990, by Kaplan and Norton a new kind of leadership and performance management system was developed, which is suitable for solving the problems mentioned above. The traditional system of financial point of view was expanded by three others - customer, operational processes, learning and growth. It combines financial and non-financial aspects, makes balance between short and long-term approach, contains an objective assessment, enables the indicators and subjective judgment. The indicators provide information to the owners as well as to other stakeholders. It involves forward and retrospective elements. Creators call this Balanced Scoreboard which has become popular at companies

¹¹⁵ KAPLAN, ROBERT S. – NORTON, DAVID P.: Balanced Scorecard, KJK Kerszöv Kiadó, Budapest, 2000.

- 📖 **Balanced Scorecard: a governance and management system, which is a key management processes - Designation of individual and team goals, compensation, resource allocation, planning framework and strategic feedback and learning -. BSC is not just a tactical or operational scorecard, but a measurement-oriented strategic management system which will help you to track the strategy and implementation.**



71. Figure: Structure of the Balanced Scorecard ¹¹⁶

B. Viewpoints of Balanced Scorecard

Balanced Scorecard is essentially a multi-dimensional index system which includes both financial and non-financial aspects. The indicators in it should be consistent with each other and with the corporate strategy, and interaction between them prevails. Derived indicators (from vision, mission and strategic purposes) has four aspects (points of view), but typically each index could be assigned to financial objectives and indicators.

¹¹⁶ Source: GYÖKÉR IRÉN – FINNA HENRIETTA – KRAJCSÁK ZOLTÁN: Human Resource Management, educational materials, Budapesti Műszaki és Gazdaságtudományi Egyetem Gazdaság- és Társadalomtudományi Kar Üzleti Tudományok Intézet, 2010., 131.p.
http://bme.ysolt.net/GTK_MuszakiM_MSc/S1_Emberi_eroforras_menedzsment/Emberi%20er%F5forr%E1s%20menedzsment.pdf

1. Perspective of Financial performance: BSC keeps this category, as it serves important indicators as a summary information on the past events of the measurable economic consequences. Financial perspective reflects the owner's expectations of corporate objectives. Financial performance indicators show that the company's strategy contributes to the company's profitability. The indicators could be for example. yield per working capital, the result of the service / business performance or added value as well.

2. Perspective of the customers: In BSC's customer point of view, managers identify the customer / consumer and market segments where the business unit intends to compete and determine the department's performance metrics. Performance boosters could be: short lead-time, on-time delivery, innovative products and services that appear again and again. The essence of customer perspective is that it is based on real customer need, customer requirements. Indicators should be established to increase customer satisfaction.

3. Perspective of Operational processes Indicators of business processes focus on processes that have the greatest impact on customer satisfaction and of course on the greatest influence on the organization's financial goals: These are the processes for which the company has to provide superior performance. These processes enable business units to provide a value on specific market segments, to retain customers and to win new customers and satisfy the owners' expectations with excellent financial results. The traditional approach follows and improves the existing processes but in this method new processes approach as well. Some methods take into consideration operational processes for example the so called (short wave) begins with order and ends with delivery - In case of BSC the company has to achieve long-term financial results. It needs to create new products and services those that satisfy new consumer needs of the present and future. The innovation process is a long wave of value creation (long wave).

4. Perspective of Learning and development: Learning and development determines the infrastructure that needs to be developed in order to ensure long-term growth and development of the organization. Basic target groups are people, systems and processes. The financial, customer and operational viewpoint usually reveals large differences between present and the future needs of people, systems and processes. In order to resolve differences companies invest in staff in

advanced studies, in improvements in IT and information systems, as well as to coordinate the organizational procedures and routines. Performance indicators are related to employees (employees' satisfaction, fluctuations rate) and general indicators are included as well.

12.2 SUMMARY AND QUESTIONS

12.2.1 Summary

Corporate strategy and methods should relate adaptively and proactively to social and economic environment which is changing increasingly fast. The unit is according to the sections of strategy management and discusses the company's strategy planning, implementation and evaluation. The different levels of strategy development were introduced and the most important aspects related. In connection with strategic planning BCG matrix and Porter's competitive forces model was presented in connection with the examination of external environment. To analyze internal environment we used competency tests, and the method of value chain analysis. We discussed Porter's competitive strategy out of many potential strategies. To the special view points of strategy implementation we used 8S-model and to determine implementation's success we used the balanced Scorecard system.

12.2.2 Self-check Questions

Briefly describe the main stages in the development of corporate strategy in a few sentences!

Understand the concept of strategic management and its main stages!

Describe the various levels of strategy-making!

Describe the main assets of strategy analysis, BCG Matrix, Porter's competitive forces model!

Describe the main types of corporate resources!

Define the concept of the value chain, and describe the elements of Porter's value chain!

Define the concept of benchmarking and its types!

Describe Porter's competitive strategy and the main types of it!

Describe the requirements of successful implementation of corporate strategy (8S)!

Describe the concept of Scorecard and its structure!

12.2.3 Practice Tests

1. The owners play a key role in shaping company's strategy. FALSE
2. Top-level managers are involved in detailed elaboration of the strategy. FALSE
3. Those interlinked processes inside and outside the company, along which value, embodied in the final product / services, is created, called value chain. TRUE
4. Benchmarking compares the company to the average. FALSE
5. Concentrated strategy could be based on discrimination as well. TRUE
6. Authoritarian, centralizing management methods always help successful implementation of strategy. FALSE
7. The basis of strategic implementation often means the use of resources, which financial indicators are not able to measure. TRUE

13. SUMMARY

13.1 SUMMARY OF THE CONTENT

Business Economics is Social Science discussing theoretical principles of company operations in a multidisciplinary way, researching motivations, causes of complex activities and examining their results. Its approach is based on four pillars: Microeconomics, Contingence Theory, Stakeholder Aspects, Strategy Approach. Business Economics is mostly concerned with peculiarities of large companies from strategy aspect, however, part of phenomena, correlations may be valid for smaller companies and different time schedules as well.

An enterprise as way of thinking and form of activity aims at individuals independently or organizations creating new values or achieving economic success. Business venture is an activity the basic objective of which is to satisfy consumer needs with the aim of achieving profit. Modern company emerged about 150 years ago as a result of state legitimation, so its structural frame, certain elements of its operation, its legal structure was regulated by law. The most important features of companies are: relative independance, profitable operation on long term, risk taking, challenges at real markets and legitime operation.

A company through its operation has different correlations with with other players of society and economy who are called internal and external stakeholders. The former one is composed of the owners, managers and employees, while the latter one comes from direct and indirect environment of the company. There may be large-scale overlaps between them, certain actors may have several connections with the organization at the same time.

The company performs dual value creating process expressed in its message to achieve its basic objective. These processes are manifested in production/service activities to achieve which successfully and efficiently marketing and innovation is indispensable. An essential precondition of efficient operation of companies is that the objectives of the organization are the most possible in harmony with the individual interests of the stakeholders. Company objectives can be divided by various aspects: Hierarchic structure was highlighted and functional system of vertical connections. Company management has great responsibility in creating the objectives system of the company and in the planning, organisation, coordination, direction and control necessary for achieving them. This group of internal stakeholders, possessing the necessary competencies, creates and efficiently operates the

organizational structure with the help of which the set targets can be achieved and the tasks can be fulfilled.

When creating it the required work distribution theories must be determined, the proper scopes of responsibilities and applied coordination methods must be set up. The basic organizational configurations discussed (linear, functional, divisional, matrix) were represented by historic and also company size aspects.

The principles of the emergency and operation of companies were discussed by using the theory of transaction costs. The correlation of market and bureaucratic coordination (very often replacing or completing the former one) as main mechanism of regulating modern (mixed) economies determines the activity of the companies, assigns the limits of their operation, organization. Their relationship with the stakeholders is – usually – characterized by all of the mentioned coordination mechanisms (market, bureaucratic, ethic, aggressive). In the past decade role of ethic coordination has increased manifested in social responsibility of companies. CSR concept is a company procedure when organizations voluntarily incorporate social and environmental aspects in their economic operation and connections with the partners concerned.

From among company functions (which also represent various aspects of Business Economics) those were focused on which have been becoming increasingly appreciated in information-and knowledge base economy of these days. One of the most important roles of innovation as company function is to create solutions to satisfy increasing consumer demand with the aim that competitiveness of the company grow and this way contribute to sustainable economic development as well. In the past decades as a result of social and technological development economic role of human resource has also become appreciated. Properly motivated, educated, creative, experienced workforce able to work on his own also represents sustainable competitive advantage for the company. Company activities connected to human resource are mostly affected by culture, traditions and social norms on long term and tools systems of state economic policy on short term.

In the past two decades a tendency has been appearing in several industries, that is human resource management has been becoming separated from management areas and knowledge management fulfils an independent function. The main task of this company area is to create organizational knowledge, that is knowledge capital from individual knowledge of the members of the organization to be the most effectively used also as source of innovations. In paradox way this organizational

function plays synthesizing role between human resource management and innovation functions.

In creating, accumulating, applying knowledge capital not only internal stakeholders are involved, but groups of the external environment of the company have been increasingly important. Information gained about customers, competitors, knowledge elements gained through activities with strategic partners are directed into its organization. These are the processes creating the basis of so called open innovation models. Collection of data from internal and external company environment, their conversion in information, organisation, storage and forwarding to the decisionmakers concerned are done by company information system. Surge of the volume and quality of information technology nowadays is completely transforming majority of business life.

The most important role of company in economic sphere is that it performs transformation processes by utilizing various resources as a result of which output is created representing value for consumers to satisfy their need. This transformation, chain of activities is called value-creating process, the most important elements of which are production and service provision and also logistics as a basis for smooth performance.

In the economy of 21st century quality has become a dominant competition factor, so it has got important role in strategic aspects of the company. Systematic application of tools and methods of quality management has become indispensable in business sphere. In the focus of TQM quality philosophy and management concept, increasingly widespread nowadays, quality is placed which expresses both customer- and society orientated approach of the company.

In business life processes to achieve principle objectives of a company, to determine alternatives leading to realising its message, their assessment, then choosing the most appropriate one, detailed elaboration and implementation are included in strategy. It is a guideline for company management which may help survival and successful future operation of the company. Company strategy in traditional sense is built on three levels, so obviously managers of the three level take part in its elaboration and implementation. The aim of all-company strategy is to improve successfulness and efficiency of the organization by creating a company portfolio. To achieve it companies must be more and more adaptive and proactive to the changes of social and economic environment. Targets of business entities, methods to approach them, and combinations of necessary resources are contained in business branch strategy. Functional strategies contain determined targets, methods and means related to certain areas of the company, such as

innovation, human resources, production, sales, etc. strategies. Consistence of various strategies, both in horizontal and vertical relation, is an important aspect at various company levels. Aim of finance strategy is to make and implement investment and (related to it) financial decisions necessary for the successful and efficient work of the management and resulting in long term increase in the value of the company. Financial plan shows financial aspects of visions described in company strategies using various reports the most important of which are balance sheet and cashflow.

14. 14 KIEGÉSZÍTÉSEK(AZ EGÉSZ FÉLÉVHEZ)

14.1 14.1 IRODALOMJEGYZÉK

14.1.1 14.2 Hivatkozások (Számozásos módszer)

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14.2 MÉDIAELEMÉK ÖSSZESÍTÉSE

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