RESOURCE MANAGMENT IN A COMPETITIVE ENVIRONMENT

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BEFEKTETÉS A JÖVŐBE

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1. INTRODUCTION

1.1 OBJECTIVES, COMPETENCES, COURSE REQUIREMENTS

1.1.1 Objective

The course titled *Resource-management* examines the operation of businesses from the point of view of how the resources needed to carry out their activities can be acquired and utilized effectively. It is examined by involving several disciplines relying on the major principles and connections of strategic planning, marketing management, production management, financing management and business economics. By means of the subject, it also examines the conditions and legalities of how to operate organisations and businesses successfully in a competitive market environment.

The aim of the course is to get students acquainted with the resource systems available for organisations as well as the principles and methods of utilizing them effectively since goals can be set and achieved only as a function of the resources available and the market environment.

Students get familiar with the factors influencing the external and internal environment of businesses; acquire their main examination possibilities and the different ways of business operation planning. The characteristic features and functions of business operation systems, the principles and methods of determining and ensuring the necessary resources will also be dealt with. Besides, students get to know the essential components of marketing and finance activities supporting the operation of businesses as well as they get an insight into the main fields of change management. At the end of the course students get an overview of the operational efficiency of organisations and businesses, and methods and possibilities of measuring performance.

1.1.2 Competences

After completing the course successfully, students will be able to assess the external and internal factors influencing business activities, to get to know their impact on business, and thus they will be able to plan the strategic directions of an organisation and to identify the external and internal factors influencing market success. They will also know and be able to apply the possible principles of competitive strategy.

Students will be able talk about the life-cycle stages of businesses and products, and the characteristics of the particular stages. They will be able to compile the business plan of an organisation at its start or to support an investment decision. They will be able to present the importance of financial planning a well as the aspects of the efficiency of operations and service systems. They will learn how to adapt to the change of market trends, how to control strategic success and the performance of the whole organisation.

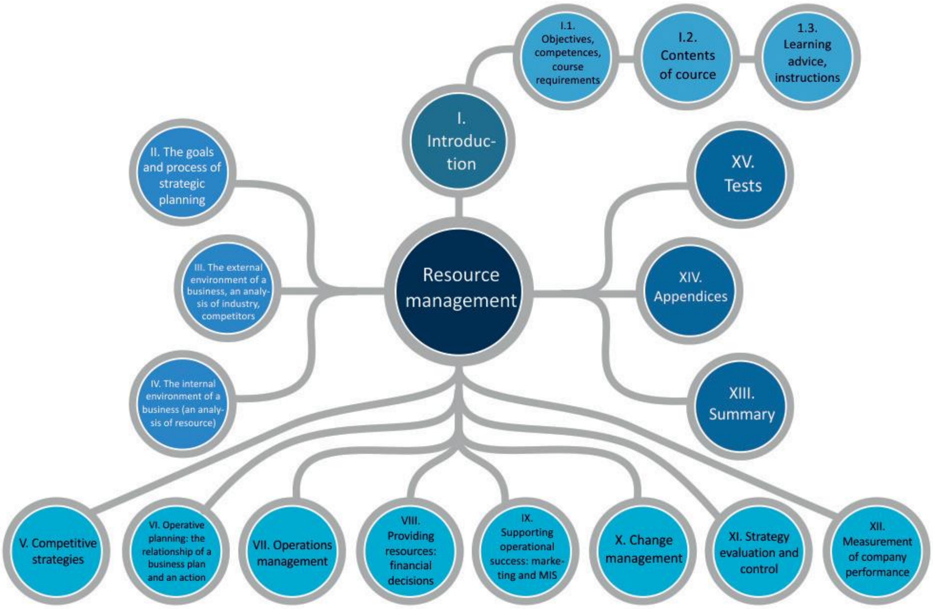
Students will be able to manage the resources of their own business, organisation or organisation unit in their special field effectively and successfully, to give professional advice to economic participants, to develop themselves, and build a career via lifelong learning. Furthermore, they will be able to do independent activity analysis, to follow the changes in the internal and external environment of an organisation, to reveal and systemise facts and carry out a critical analysis by using their theoretical and methodological knowledge. Students will be able to form their own views on the effective use of resources of a business and to defend them in a discussion. On the basis of this, they are able to draw conclusions of their own, to express original thoughts, and suggest solution methods while taking measures to maintain competitiveness. They will be able to create strategies to solve problems of managing a business, to find a solution and make decisions. They will be able to reconstruct the use of resources to match the changes of goals and environment as well as to monitor the achievements of the goals set, to measure business performance and carry out necessary modifications.

During the course students will acquire strategic thinking and planning skills. They will perceive the activities related to resources management of an organisation or business. They will recognise problems; coordinate planning, research and fields requiring analysis. They will strive to recognise the capacities and possibilities of how to achieve business goals, and to use them effectively in order to satisfy customers' needs.

1.1.3 Course requirements to be fulfilled

There is no prerequisite for the course. In order to complete the course, students are provided with required and suggested readings, which are important for students to complete the course effectively and to be able to apply the knowledge they have acquired successfully in practice. The video materials included in the course are closely related to the theoretical course material and enable students to recognise connections between them. The external URL links are meant not only to support the theory with examples, but to help students to memorise them as well. The recordings inserted are supposed to facilitate students understand complicated figures better. The basic requirement to complete the course successfully is to do a written test, the pass mark of which is 50 % + 1 point.

1.2 CONTENTS OF THE COURSE (FROM 1TO 15) (2-13 CORE MATERIAL)



1. ábra: Contents of the course

1.3 LEARNING ADVICE, INSTRUCTIONS

The objectives of a relevant lesson and the structure of the course are given at the beginning of each lesson. It is followed by the presentation of the theoretical material. At the end of each lesson there can be found a summary of the most important points discussed in the lesson and assessment questions which are meant to help students to prepare for the exam. Students can control their knowledge by doing practice tests related to each lesson.

The video materials and animations included in the course are designed to facilitate the acquisition of the theory. At the same time bear in mind that there are also exercises related to them, and pay such close attention to them as to the text of the lesson.

URL links are also attached to the material, which are meant to illustrate, supplement the material to be acquired, and enable students to understand it and to put knowledge in practice. Therefore it is advisable to search for the articles and studies referred to in the links, save them on your own computer so that they can be made available for later use as well.

By using the key words in the titles of the lessons, students can also search for case studies and examples on the internet on their own, which will make understanding and acquisition easier, more interesting and quicker.

Watch changes on your family members, friends and acquaintances, or try to find well-known businesses and examine how the topics discussed in each lesson operate in the business chosen. Try to formulate your own critical remarks and try to outline possible solutions using what you have learnt!

If you should have any further questions related to the lessons, turn to the instructor of the course or use the forum and chat.

We wish you much success in your studies!

2. GOALS AND PROCESS OF STRATEGIC PLANNING (G. SOÓS)

2.1 OBJECTIVES AND COMPETENCES

While operating a company, the goal of management is to eliminate the risks threatening its operations at a highest possible level, and to be prepared for changes. This is what enables it to make its operation effective and successful. In order to achieve this, the risk factors threatening its operation, the expected changes of the environment must be assessed and it must be formulated what principles, goals and activities could be applied to make the business successful by adapting to these risk factors. The means of achieving these goals is strategic planning.

The aim of the lesson is to make students acquainted with the essence of strategic planning, the goals of its formulation and its basic concepts. Relying on this, students will be able to present the necessity, the concept, the time horizon of strategic planning and its various approaches, furthermore, they will be able to determine what planning activities belong to which company level of planning.

2.2 COURSE MATERIAL

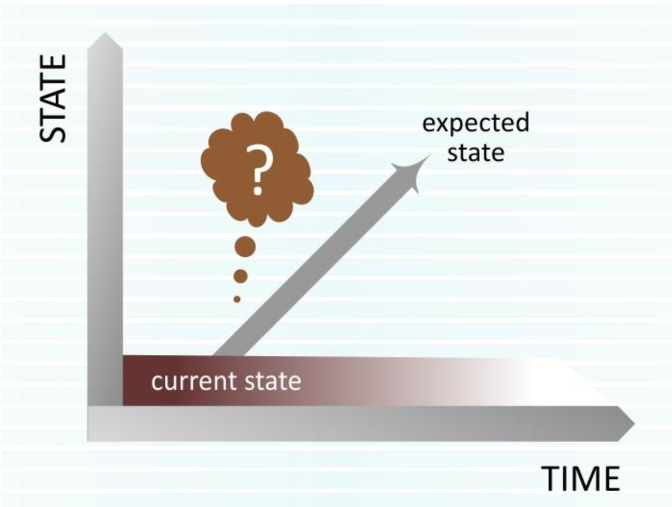
2. ábra: Concept map

2.2.1 The concept of strategic planning

„Strategies are both plans for the future and patterns from the past”[1]

The primary goal of operating a company is to achieve profit besides satisfying the needs of consumers as effectively as possible. In order to achieve this goal, the management acquires the necessary resources and organises, coordinates and manages their joint operation. Company management (especially in the case of micro and small businesses) is often of intuitive, i.e. decisions are made by the manager always according the given situation with an operative character. It is more characteristic of bigger, developing businesses that it is planned in advance by what principles they would like to operate their business. Such businesses mostly have a strategy plan.

The concept of strategy derives from the Greek word *stratēgia*, meaning "art of troop leader; office of general, command, generalship". The job of a troop leader was to organise the operation of the army, to coordinate the supply of food, clothes and arms. By now strategy has become an important tool of planning business life.



3. ábra: The concept of strategic planning

During strategic planning the company sets its main goal that it intends to achieve during the given time frame of operation. To formulate the main goal, it must be fully aware of the present situation of the business, whether the set goal can be achieved or not, and if it can, what

[1] Henry Mintzberg: Crafting Strategy Harvard Business Review 1987. július-augusztus

way leads to it and what means are necessary for it. At the same time, an important part of strategic planning is to create and coordinate the conditions for adapting to the changing environment.

In his book[2] published in 1962 Chandler examines conglomerates of the USA, and as a result he describes strategy as planning and implementing the diverse growth of companies.

Examining the significance of strategy, in the 80s Danny Miller and Peter H. Friesen[3] pointed out the connection of environment and strategy. Accordingly, strategy is the answer of a company to the challenges of the environment.

The concept of strategic planning is defined by Henry Mintzberg[4] as follows: strategy is a plan – a process of consciously planned steps, a guiding principle and adaptation to the given situation.

Mintzberg mentions that the term 'strategy' also exists in game theory, where it refers to a complete plan that determines the players' choice in every possible situation.

In management it is a comprehensive and integrated plan, planning to make sure that the company achieves its primary goals.

In summary, strategic planning is for businesses to plan what kind of goals they want to achieve from a given situation, in order to achieve them what steps they plan to take, and what assets they intend to mobilize. As is directed, a plan contains the activities to be performed, to which it aligns costs, deadlines and persons in charge.

2.2.2 The 5Ps of strategy

Mintzberg – similarly to the 4 P-s of marketing – created the 5P theory of strategy. Accordingly, strategy means the following:

1. **Plan:** Strategy is a plan, a direction, which deals with the given situation, and it creates actions and measures to handle it.
2. **Ploy:** Strategy is the means of fight with competitors, it refers to actions which refer to measures taken to outwit or deceive competitors in order to gain a competitive advantage.

[2] Alfred D. Chandler Strategy and Structure: Chapters in the History of the American Industrial Enterprise. MIT Press Cambridge1962.

[3] Danny Miller,Peter H. Friesen: Strategy-making and environment: The third link Strategic Management Journal Volume 4, Issue 3, pages 221–235, July/September 1983

[4] Henry Mintzberg: Strategy-Making in Three Modes, California Management 1973. Review Vol. XVI. No. 2. pp. 44-53.

3. **Pattern**: The goal of planning is a behaviour that goes with an appropriate result, conceiving a pattern which results in achieving a proper goal. Its basis can be taking a former behaviour into consideration.
4. **Position:** It refers to the position of a business in its environment. A part of it is, for example, power relations in a competitive situation, the uniqueness of products.
5. **Perspective**: Perspective indicates the way, shows the goal that determines the structure and implementation of strategy. This perspective varies among the different members of an organisation, collective knowledge is behind it.

2.2.3 The primary goals of strategy planning

”Business strategy – matching company strategy – determines the position intended to be reached in the industry, the developments and resources needed to achieve the goals, and it arranges all these into an action programme meant to maintain a competitive advantage in the long run.”[5]

The goal of strategic planning is to reveal and assess accurately the present situation, the problems to be solved as well as to set the goals along which the management imagines the company’s future operation.

Accordingly, strategy:

- determines the future goals of an organisation for the given time frame
- indicates the guidelines and principles of its future operation
- aligns activities with them in order to achieve the given goals
- determines the tool systems for achieving and maintaining a competitive advantage
- determines the methods of adaptation to the environment
- gives orders about the distribution and effective use of resources
- provides the basis for the expectations of owners to be met

2.2.4 Basic types of strategic approaches

Three basic types of strategic approaches can be distinguished[6]:

[5] Bartek-Lesi Mária – Bartók István - Czakó Erzsébet – Gáspár Judit – Könczöl Erzsébet – Pecze Krisztina: Vállalati stratégia Alinea Kiadó Budapest, 2007. 75. o.

[6] Chikán Attila: Vállalatgazdaságtan Aula Kiadó Budapest 2006. IV. fejezet alapján

1. **Entrepreneurial Mode:**

- typically businessmen running one-person businesses
- strategy is guided by looking for new possibilities
- "policy of big steps", puts a brave face to an uncertain future
- meeting problems head-on in a bold way
- the main goal is growth
- the environment can be shaped

2. **Adaptive mode**

- typical of businesses which work in an extremely complicated environment
- there are no clearly set goals
- "reactive solutions" (reactions) to the challenges of the environment
- non-initiative actions
- disconnected decisions

3. **Planning mode**

- well-circumscribed goals
- active influence of the events
- an important participant of planning is the analyser
- systems-view of planning
- integration of strategy and decisions related to it.

You can read about **the strategic goals of the Coca-Cola Company**, the world's biggest manufacturer of soft drinks at the link below[7].

2.2.5 The process of strategic planning

If strategy formulation is triggered by the solution of current problems, the first step is an accurate description and analysis of the problems. It is important to reveal what kind of possible impact the problem has on the business (e.g. appearance of a new competitor – loss of market share).

In order to formulate a strategy, it is indispensable to get familiar with the present situation. Thus it is necessary to reveal the potentialities, resources and possibilities of the business. Among others, the situation and the structure of the current product range, capacities, human resources, the financial situation and the results of previous marketing activities must be assessed, and the successes and failures of price and

[7] http://www.coca-colafemsa.com/femsa/web/conteudo_en.asp?idioma=1&conta=44&tipo=27617

sales policies must be revised. To achieve goals, it is essential that company managers, strategy planners should be fully aware of the company's competences to be able to formulate realistic goals.

Situation analysis should also extend to the analysis of the external environment. To do this, the structure of the relevant market (the market where the company appears with its products), the power relations and strategy of competitors, the needs and behaviour features of consumers, the characteristics of the relationship and cooperation with suppliers and salespersons must be examined. It is important to assess in what kind of a social, economic, legal and natural environment the company operates.

However, it is not only the events of the previous years (1-5 years) that play an important role for these factors, but it is also important to estimate how current processes are expected to change in the future. For example, essential aspects are also change in consumers' preferences (e.g. the spread of healthy lifestyle), what kind of regulations are planned to be introduced by the state (e.g. expected modifications of tax rules) or what impact social changes have on the operation of the company (e.g. work force migration).

Of course, these factors cannot be predicted with entire certainty but knowing the given situation we must try to estimate them as well as possible in order to set realistic goals.

While planning, it is important to collect experience about whether the management has taken any previous measures before to solve the problems arising during the planning process. If it has, it must be assessed how successful the decision made in the past was and plans for the future must be formulated accordingly. In connection with this, read the **Forbes report made with the marketing manager of the Coca-Cola Company!** [8]

On the basis of the situation analysis the goals will be set and accordingly, the activities, costs and the persons in charge will be aligned with them on the different levels of planning (the levels of strategic planning, sub-chapter).

Planning will be followed by implementing the strategic activities. The success of performing these activities must be continuously monitored, i.e. it must be assessed how successfully they were executed. If it should deviate from the plan, intervention, plan modification or continuous re-drafting could be needed. Thus, controlling the plan can react upon the original process.

[8] http://www.forbes.com/sites/avidan/2013/10/07/just-how-does-coca-cola-reinvent-itself-in-a-changed-world/

2.2.6 Time frames of strategic planning

While analysing and planning the processes, a company can take various time frames as a basis. Accordingly, planning can be of long-term, middle term or short term or immediate. Depending on what time frame we must plan for, we must use different approaches and different methods.

Plans for a longer time frame are called strategic plans, the ones for middle term are called business plans and the short or immediate plans are called operative plans. Strategic and business planning encompasses all the departments of a company while operative plans cover the activity of one single department. Larger companies have a strategic plan, they break down their business plan from this and from the latter their operative plan, and thus they form a hierarchical system (see the levels of strategic planning).

Plans can differ according to the time frame, and there are often overlaps between particular types since the customer who orders the plan (e.g. a credit bank or a venture capitalist) can require that a longer (or even a shorter) plan should be made than how it was interpreted in the definition. Thus, for example, in the case of the categories described below it can happen that for a larger investment a business plan for 5-10 years must be made although a business plan is generally meant for one year. Consequently, let us consider these time spans in such a way that the given goal can overwrite the general principles.

2.2.7 Levels and time horizons of strategic planning

As an introduction to this chapter it must be pointed out that even among the leading researchers of the professional field there is no agreement about what the certain types of plan should be called and what their main characteristics are, and there is no uniform term usage in the current academic literature. This chapter is designed to present how the different levels of strategic planning can be interpreted.

In strategic planning the process can be interpreted at the levels below:

4. ábra: The levels of strategic planning

The pyramid that can be seen in the picture shows the hierarchical system of goals. Accordingly, planning can be **"top down"**, which is the method initiated by the top-level management, or **"bottom up"**, which starts by the initiative of the lower levels of company hierarchy (workers, low-level management). Related to principles of planning, it is worth mentioning the EU's principle of subsidiarity, which means that decisions should be made there and at that level where the most information needed for planning is available.

In the following, the different levels of strategy will be presented on the basis of the "top down" planning.

At the top of the hierarchy the starting point is formulation of **prospects for the future/ a vision** by the management. Here a perspective future state that the business intends to reach (for 5-10 years or for even a longer time) must be determined and imagined. Among others, it can be a market leading role, or achieving a given market share or given powers relations against competitors or gaining a certain range of customers.

While trying to formulate a **mission/philosophy,** company managers are making an attempt to find an answer to what the goals of the business are, what roles the business intends to play, what the function of the organisation is, what the basic principles and values of its operation are, and what its relationship to its environment is like. Most companies formulate either a vision or a mission, the difference is very often only in the way of how it is formulated. It is important that the mission should necessarily be short and striking. Besides, it is essential that a certain vision or mission is meant for a longer period, its time horizon is similar to that of a vision. **You can read about the mission and vision of the Volvo group** at the link below[9].

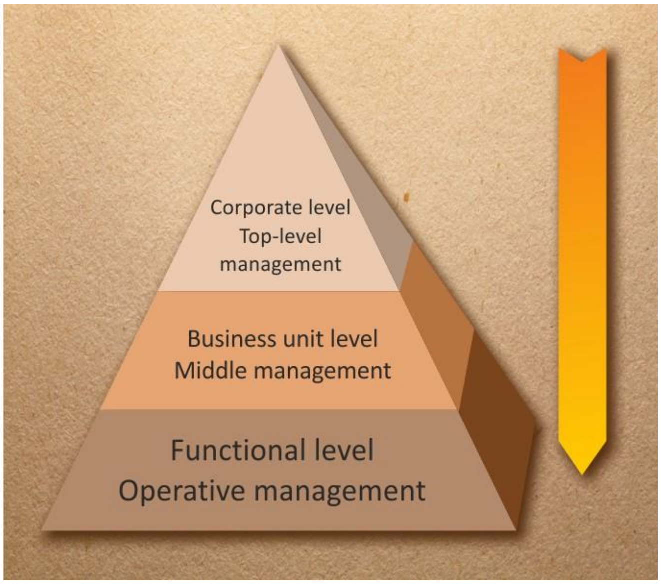
A strategic plan is made for the whole corporate, fixes the most important goals, the results to be achieved and the methods needed to achieve goals. In the middle of a strategic plan the so called strategic focuses can be found. The strategic focus refers to the activities of a company which basically determine the character and the successful operation of a company. Typically it is made for a period of 2-5 years.

A business plan also affects the whole corporate and typically it is made for a period of 1-3 years. In the business plan the goals formulated in the strategy are broken down onto the different business units of the company. Thus, on the basis of the strategy, for example, the purchase plan, the marketing plan, the sales plan, the financial plan and the human resources plan are prepared. An important task of the business plan is to coordinate the different business units of the company on a strategy basis.

Tactical or action plans are made for a short time frame (several months), for maximum 1 year for the certain functional units or departments of the company. The activities determined in the business plan are broken down onto concrete measures referring to the given department (e.g. employing 10 new employees for the production on the basis of a HR plan).

The formulation and breaking down of the strategies happen at the different levels of a company.

[9] http://www.volvogroup.com/group/global/en-gb/volvo%20group/our%20companies/FBS/volvo_treasury/vt_vision_mission/Pages/vision_mission.aspx



5. ábra: The levels of business planning

Implementing the highest level of planning is the task of the top management. Here the company philosophy to be followed, the goals must be determined at **corporate level**, **company-wide**, the main changes of environment affecting the company must be estimated, and the principles by which the certain part strategies can be broken down must be determined. The task of the top management is to work out the methodology by which it will be possible to control the implementation of strategy.

The determination of tasks for the particular business units will be the responsibility of the level of the mid-management. **The business unit plan** formulates the special goals, tasks and activities for the particular business units, organises the implementations of plans and takes part in controlling them, provides data for the top management.

Functional objectives comprise the concrete tools, activities for the implementation of the goals of business units, in other words actions. In the plans the steps, the time span, the date, the resource-and-cost demands, responsibilities and competences and the anticipated results of the activities to be carried out must be accurately determined. The task of the functional level is to implement action plans and to enforce the principles determined in the strategy during each operational decision.

In strategic planning an important term is that of SBU (strategic business unit), which is the basic unit of strategy formulation. ”It is an organisational or planning unit, which comprises a group of products and services which are sold by the company for a definite group of consumers, and in which field the company competes with competitors. "[10]

At corporate-level the following target-fields must be involved in the strategy[11]:

1. The company's present range of activities and the ones that it intends to develop: here it must be evaluated how the various activities and business units perform, and on the basis of the results decision must be made about which fields should be kept at level, which ones should be stopped or developed. If the company plans growth, a new range of activities and business units, divisions can be introduced (e.g. a toy selling firm can start to sell articles of clothing) or the present activities can also be extended (e.g. traditional retailing can be complemented by online trading).

2. Company (market) diversification: the company assesses what market and range of consumers it has served so far, which products were the most or less successful. The company can make a decision about whether it wishes to gain new markets or extend the present ones or try to serve the market available in the future as well. At the level of products, the company introduces new products or new groups of products, tries to sell more of the present products or it might recall *non-profitable* products (products that do not produce profit) from the market.

3. Company's partnerships: the principle must be determined by which it can be expected to start, shape or stop partnership with suppliers, retailers, rivals or at social level. For example, if the basis of selling strategy involves serving customers as directly as possible, personal relationship, then sales do not open towards multinational chains.

The goal of companies is generally to build long-term co-operations with their partners since operation can be planned and becomes stable by this. For example, the quality, the quantity and delivery conditions of a raw material coming from a familiar, regular supplier can be forecast well on the basis of previous experience, and it usually involves a kind of flexibility in case demands or conditions change (e.g. a new colour trend appears in clothes manufacturing and the raw material will be ordered accordingly).

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[10] Bartek-Lesi Mária – Bartók István - Czakó Erzsébet – Gáspár Judit – Könczöl Erzsébet – Pecze Krisztina: Vállalati stratégia Alinea Kiadó Budapest, 2007. 75. o.

[11] Bartek-Lesi Mária – Bartók István - Czakó Erzsébet – Gáspár Judit – Könczöl Erzsébet – Pecze Krisztina: Vállalati stratégia Alinea Kiadó Budapest, 2007. 9. fejezet alapján

4. Company portfolio and organisation development: ”The portfolio of a company is comprised by the whole of the strategic business units of diversified companies.” The top management designates the business units, the company's target fields which yield the best results for the company. Thus certain business units will be stopped, new ones will be introduced and priorities, references will be rearranged among their divisions.

2.3 SUMMARY, QUESTIONS

2.3.1 Summary

In order to survive in the long run, companies must be prepared for the continuous change of the changing environment, the appearance of newer and newer risk factors threatening the various departments of the company. Consequently, the goals and activities of future time period(s) must be estimated. During strategic planning the company assesses the impacts of the environment on its operation and estimates their expected changes in the future. It examines activities of the company's departments performed till then, and the efficiency of business. On the basis of this, the company plans the principles and goals on which it intends to manage its operation in the future. The main features of strategy are summarised in the 5Ps model.

Strategy was discussed from three approaches: entrepreneurial, adaptive and planning approach, on the basis of which the certain behaviour types of planning can be characterised.

The process of strategic planning can start either at top management's decision or at the so called ”bottom-up” initiative. It is triggered by conscious planning or recognising some kind of a problem. In the case of the latter after the problem being analysed accurately, a situation analysis is done within the company and in its environment. It is important to examine the results of previous similar cases. By taking all these into consideration, the strategy will be formulated and implemented. It must be borne in mind that the process is not over yet since it must be continuously examined during the planned period and after it to what extent the plans were fulfilled. It enables the management to correct the activity not efficient enough still in its process or later on.

Depending on what time frame the plan is made for, we can talk about strategic, business and operational (tactical) plans.

The various plans can affect the various levels of the business. Strategic planning is to be done by the top management and comprises the whole company. Business plans and business unit plans are broken down from strategic plans and they should be prepared by the mid-management and comprise all the business units of the company. Functional plans are made at the level of lower-management, refer to certain functional units or departments and contain such measures, actions which are necessary for achieving the goals formulated in the strategy.

2.3.2 Questions for self-assessment

1. Describe the concept of strategic planning.
2. What do the 5Ps of strategic planning mean and what are its components?
3. What are the goals of making a strategic plan?
4. What three basic types of strategic modes do you know? Characterise these types briefly.
5. Describe the steps of the process of strategic planning and characterise its every single step briefly.
6. What kind of strategic principles were formulated by the Coca-Cola Company?
7. What time frames is strategic planning meant by?
8. At which company levels is strategic planning realised? What are the plans made at the different levels called and who is planning made by?
9. What main target fields does a corporate strategy have?

2.3.3 Practice tests

1. Practise the concept of strategy! Match the elements of strategy and their characteristic features.

a, ploy	1. situation
b, perspective	2. environment
c, pattern	3. goal
d, plan	4. competitor
e, position	5. behaviour

2. Which one does not belong to the basic goals of strategy? There are several good answers. For each wrong answer, your raw score will be reduced by 1 point.

a. determines the means system of achieving and maintaining a competitive advantage
b. determines the future plans of the organisation for a given time frame
c. determines which supplier to break a contract with
d. provides a basis for the expectations of the owners to be met

e. provides a basis for the dreams of the owners
f. employs new people in order to achieve the given goals
g. acquires the necessary resources

3. Match the various characteristics with the particular types of strategy mode.

A) Entrepreneurial mode
B) Adaptive mode
C) Planning mode

- typically businessmen running one-person businesses
- the environment can be shaped
- reactive solutions" (reactions) to the challenge of the environment
- the mail goal is growth
- disconnected decisions, well-circumscribed goals
- typical of businesses which work in an extremely complicated environment
- "the policy of big steps", puts a brave face to an uncertain future
- system-view planning
- the integration of strategy and decisions related to it
- active influence of the events
- an important participant of planning is the analyser
- there are no clearly determined goals
- non-initiative type of actions
- strategy is guided by searching for new possibilities

4. Explain the steps of the process of strategic planning.

1. …………………………………………………………………………..
2. …………………………………………………………………………..
3. …………………………………………………………………………..
4. …………………………………………………………………………..
5. …………………………………………………………………………..
6. …………………………………………………………………………..

5. What must the business assess during the situation analysis of strategic planning?
1. …………………………………………………………………………..
2. …………………………………………………………………………..
3. …………………………………………………………………………..

6. What time frames are company plans made for, and what are they called?

1. ……………………….. time frame: …………………….. plan
2. ……………………….. time frame: …………………….. plan
3. ……………………….. time frame: …………………….. plan

7. What types of plans are made at the various levels of company management? Match the management levels, the related types of plans and the affected departments of the company. Several types of plan can belong to one management level and one company area.

Management level	Type of plan	Affected company area
A) Top management	1. prospects for the future	a, the whole corporate
	2. business plan	
B) Middle-management	3. action programme	b. one particular business unit
	4. tactical plan	
C) Lower-level management	5. vision	c. one particular functional unit
	6. strategic plan	
	7. philosophy	
	8. mission	

8. Enumerate what target fields must necessarily be involved in the strategy at corporate level.

1. ………………………………………………………………………..
2. ………………………………………………………………………..
3. ………………………………………………………………………..
4. ………………………………………………………………………..

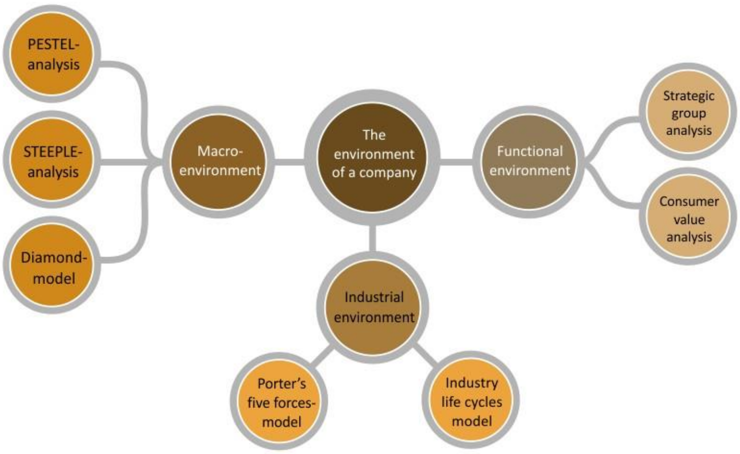
3. THE EXTERNAL ENVIRONMENT OF A BUSINESS, ANALYSIS OF THE INDUSTRY, COMPETITORS (G. SOÓS)

3.1 OBJECTIVES AND COMPETENCES

In this lesson students get acquainted with the external environment, elements, levels and the main characteristics of a business.

They will be able to apply the main methods of analysing the different environmental levels. By using different methods, students will be able to make an analysis of a company working in a given field; industry with respect to it's external environment on their own.

3.2 COURSE MATERIAL



6. ábra: Concept map

3.2.1 The external environment of a company

The case of the boiling frog:

If you place a frog in a large container of boiling water – feeling the dangerously high temperature –, it will jump out at once. However, if you put the frog into a container of cold water and you heat the water slowly even to the boiling point, it will stay calm and die in the hot water. In the experiment the frog didn't notice the slow and dramatic change of its environment in the long run.

Before a company starts its operation, and during its operation, it must watch the external environment and its changes continuously, and it must estimate the expected trends and the effects influencing the company. First of all, it must be made clear what the environment of a company means.

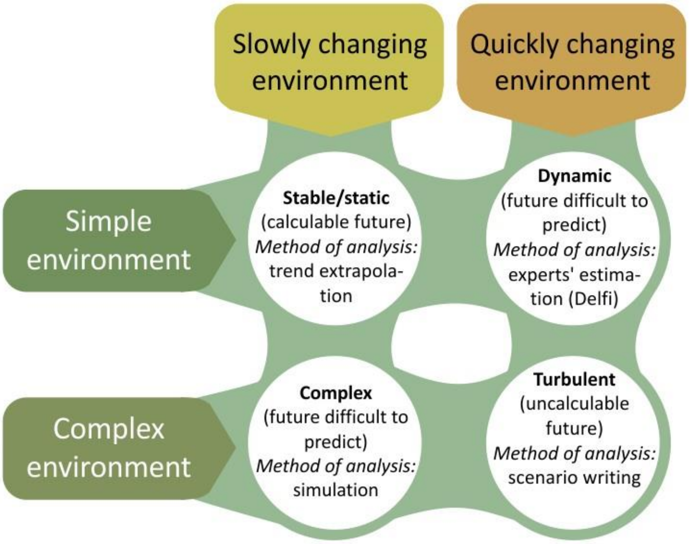
- *Environment* **for a company means all the factors which have an effect on the operation of an organisation in the present or in the future. An analysis of the environment outlines a picture of the change of the external factors affecting the organisation – considered important from certain aspects – at a time horizon determined the strategy to be formulated.**
- *The goal of analysing the environment* **is to state how the potential opportunities and threats can be used for the benefit of the company: to make use of the favourable opportunities, to avoid and fend off threats shattering company positions.**[12]

A company is characterised by two factors, complexity and dynamism. **Complexity** means how complicated and multi-factored the environment is in which it operates. The more complicated an environment is, the more difficult analysis and planning are since there are fewer chances for considerations.

Dynamism means how much time is needed for the environment to transform, or in other words how quickly the results of an examination and the plans prepared accordingly lose their up-to-datedness and usability.

Accordingly, environment can be of various kinds, and different environments require different methods of analysis and planning. It is summarised in the following figure:

[12] Barakonyi Károly: Stratégiai tervezés Nemzeti Tankönyvkiadó, Budapest 1999. 114-115. o.



7. ábra: An approach to the environment of a business

If a simple environment goes through only slow changes, the situation can be regarded to be stable and calculable. In such cases it is enough to observe past data and tendencies, to describe them by means of simple mathematical and statistical models, and to estimate them for the future on the basis of these models.

If a transparent environment changes at a quick pace, then the degree and pace of change can influence the result of the given period considerably, and thus **trend-extrapolation** is not enough. It must be completed or modified by the observations and prognoses for the future made by the experts of the field.

The complicated, multi-factored environment is difficult to be modelled even if it goes through a slow change since it is impossible to take all influencing factors into consideration and plan it during analysis. In this case, the method of planning is **simulation** when under the present conditions a particular emphasized factor (later even more together) is changed, and the expected effect is described. The method functions similarly to, for example, an aeroplane simulator.

The dynamic change of a complex environment cannot be modelled or if it can, it can be modelled only to a limited degree. In this case, the method of planning is **scenario writing**, when three versions are planned by experts for the change of environmental factors and their impacts on the company. Thus there will be an optimistic, a realistic and a pessimistic version, by which a company is trying to be prepared for several possible outcomes.

The environment of a business can be interpreted at several different levels. Depending on how directly the effect of a given environmental element prevails at the company, the following levels can be distinguished:

3.2.2 Analysis of macro-environment

The widest environment of a business is the macro-environment or in other words national economy environment. In a broader sense foreign countries (international environment) interpreted in the sense of macro-economy also belong to it. The change of a rule of law or the increase of inflation can influence the efficiency of a company. However, it is manifested in the different indicators of the company not directly but indirectly.

The analysis of the macro-environment is done characteristically by means of observation.

The process of analysing the macro-environment:

1. defining the environmental segments relevant for the company,
2. picking out the factors within particular environmental segments which influence the operation of the company,
3. analysing the connection between the current effects of the environmental factors and the influencing factors,
4. analysing the expected change tendencies of the environmental factors at the strategic time horizon.

Three methods will be introduced for the analysis of the macro-environment below:

3.2.2.1. PESTEL-analysis

One method for analysing the macro-environment is the PESTEL-analysis, which is an acronym, made up of the initials the environmental elements to be analysed.

- P – political: political environment
- E – economic: economic environment
- S – sociocultural: socio-cultural environment
- T – technological: technological environment
- E – environmental: surrounding environment
- L – legal: legal environment

The particular environmental elements offer unlimited analysis. However, the main parameters to be examined are as follows:
11_03_k03.jpg

8. ábra: PESTEL-analysis

3.2.2.2. STEEPLE-analysis

Besides the PESTEL-analysis, the STEEPLE-analysis can be used, where the meanings of the initials are as follows:

– S - social
– T - technological
– E - economic
– E - environmental
– P - political

- L - legal – international and national legal
- E - educational – the development of human resources

The model extends the PESTEL-analysis described above by taking the development of human resources into consideration.

In the case of both examinations we made an attempt to describe the relevant factors of the above environmental elements influencing the company as thoroughly as possible, and to estimate their changes and the impact of the changes on the business.

As the environment is complex and changes dynamically, it is impossible to make an accurate estimation. While planning, we are trying to be prepared for many different possibilities. Therefore, it is worth applying **planning with a scenario**.

Scenarios are such prospects for the future which present the impact of several important environmental factors on our strategy.[13]

Writing a scenario means that starting from our present situation we plan the changes to be expected in such a way that we give an *optimistic*, a *realistic* and a *pessimistic* version.

While writing a scenario, the following should be taken into consideration. First, in a given issue the main active forces (*driving forces*) shaping the future and the possible extent of the changes in their field (*axes*) must be revealed, and then in the case of the different combinations of the change of the driving forces (the *scenarios* shaped accordingly) estimates must be made for the processes to be expected.

E.g. It will be stated that the expected sales revenue of a product already available at the market can be analysed by examining the volume of the possible price and the expected demand, furthermore, that both "forces" can increase and decrease. That is, the four scenarios: (1) if both the price and the demand increase, and (2) decrease, respectively and (3) if the price increases, the demand decreases, finally (4) the other way round.

Next it must be examined under what conditions the realisation of these scenarios can be expected, how big their likelihood is, what their consequences are for the company, and in a given case, what measures the prospects of the company can be improved by.

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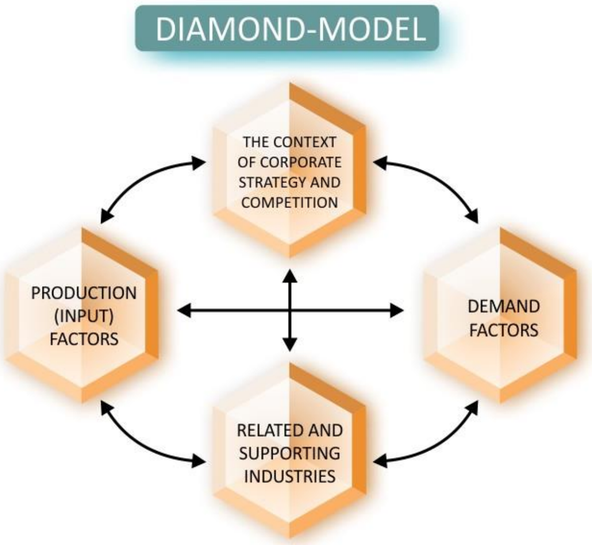
[13] Bartek-Lesi M.-Bartók I.-Czakó E.-Gáspár J.-Könczöl E.-Pecze K.: Vállalati stratégia Alinea Kiadó 2007. 83. o.

3.2.2.2. Diamond-model[14]

The third possible way of analysing macro-environment is the Diamond-model created by Michael E. Porter. In his views, a stable economic, political, legal environment is a necessary but not sufficient condition of competitiveness. The competitiveness of a company is determined by important micro-environmental factors as well.



9. ábra: Porter's Diamond model of national advantage

The particular elements comprise the following factors:

- **Production factors**: human resources, capital, physical, administrative and information infrastructure, scientific and technological infrastructure, natural resources.
- **Demand conditions**: the structure, character, volume of demand, the existence of local demanding consumers, usual local needs.
- **Related and supporting industries**: local suppliers, companies operating in related industry, industry clusters.
- **Context of corporate strategy and competition:** regulations stimulating development, investment (e.g. protection of intellectual property), business environment ensuring free competition, encouraging the increase of competitiveness.

[14] Balatoni K.-Tari E.: Stratégiai és üzleti tervezés Aula Pub. Budapest, 2007. pp.42-45.

3.2.3 Industrial environment

The industrial environment of a company belongs to the micro-environment.

Industry: it refers to a group of companies which produce products/services of the same type or which can be replaced by each other. This domain is the territory of competition strategies. Strategies the aim of which is to gain advantage over the other participants within the scope of the industry environment are called competition strategy.[15]

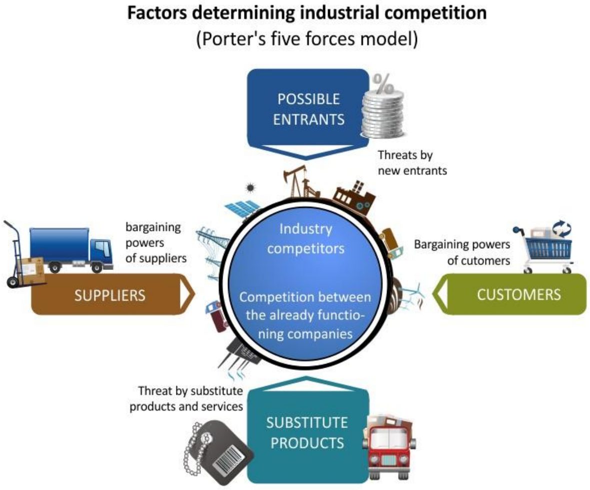
Steps of analysing industry:

1. Mapping the borders of the relevant industry for the company.
2. Analysing the structure of industry.
3. Analysing the immediate competition environment (structural analysis within the industry).

3.2.3.1. Porter's five forces-model

To analyse industry, Porter's five forces-model is used.

[15] Bartek-Lesi M.-Bartók I.-Czakó E.-Gáspár J.-Könczöl E.-Pecze K.: Vállalati stratégia Alinea Kiadó 2007. 86-87. o.



10. ábra: Porter's 5 forces-model[16]

3.2.3.1.1. The threats of new entrants

The main factors of barriers to entry:

1. Economic serial volume: new entrants have to take into consideration that they will have to compete with companies already present at the market with a determined trading volume. To be able to do so, they will have to reach an appropriate serial volume ensuring profit.

2. **Product-differentiation**: on entering a market already functioning, the business has to face the fact that the competitors already have an established range of customers and a certain kind of brand loyalty could have also been developed. New entrants will have to sacrifice significant resources to get their own range of customers.

3. Capital requirements: It requires significant capital for a new entrant to become competitive. It is especially true if the company starts with a big advertising campaign in order to conquer the market, or due to the innovative character of the product, significant research-development is done before the product is placed on the market. Here it is not only to raise capital that is a task to be solved but it must also be considered whether the refund of the capital can be risky.

4. Switching costs: these costs are paid by the customer when he switches from the product of one supplier to that of another. Such expenses are, for example, the training costs of employees, the costs of applying new auxiliary equipment and redesigning their own products,

[16] *Michael E. Porter: Versenystratégia Akadémiai Kiadó Budapest 2006. 30. o.*

etc. In the case of this factor, further obstacles are meant by the fear of change, the resistance of the customer's employees to use the new product. This risk factor can be reduced by sample products and presents.

5. Access to distribution channels: if the companies already on the market have established relationships in the distribution channels available, it is difficult to motivate the various participants of the channel to change or expand, especially if the relationships present are regulated exclusively by contracts. Distributors are reluctant to replace a firm relationship based on experience by a new, unknown and uncertain possibility.

6. Cost disadvantages independent of size: companies that have established themselves on the market earlier have such advantages that cannot be reproduced by the one that enters it later. Such are, for example, technology with patent protected, favourable primary material-access, suitable site, the possibility of government's support, and gained experience.

7. Government policy: by taking national-economic interests into consideration, the government can restrict or prevent entry into the market in certain industry of strategic importance, such as transport service and energy production.

Of course, new entrants must be prepared for the fact that the companies of the industry present on the market will react to the appearance of a new member. It has simpler and more aggressive means, and it is difficult to calculate which one will be applied by companies. It is worth collecting similar experience from the past.

3.2.3.1.2. Threat of substitute products

Substitute products offer customers an alternative to the products of a competitive company. Due to competition, price setting encounters barriers, the refund that can be achieved by the product decreases and the refund time increases, respectively. Increasing competition decreases the industrial profit more and more.

Such substitute products are dangerous which

- improve their price/performance-rate as a tendency compared to the competitive products of the industry,
- are produced by industry achieving high profit.

3.2.3.1.3. Bargaining powers of customers

The interest of customers is to force down the prices of products lower and lower by taking advantage of competition, and at the same time to expect a better and better quality and more and more services from suppliers. The bargain position, that is how big a compelling force the customer has for the supplier depends on several factors.

Customers' group is strong if:

1. it buys concentrated, or in a great quantity compared to all the sales of the sellers.
2. the products bought from the industry make up a considerable part of the customer's costs or purchases.
3. the products bought from the industry are of standard undifferentiated quality.
4. the customer achieves little profit.
5. the customers threat with backward integration worthy of credit.
6. the products of the industry are insignificant regarding the quality of the customer's products and services.
7. the customer has a whole range of information.

3.2.3.1.4. Bargaining powers of suppliers

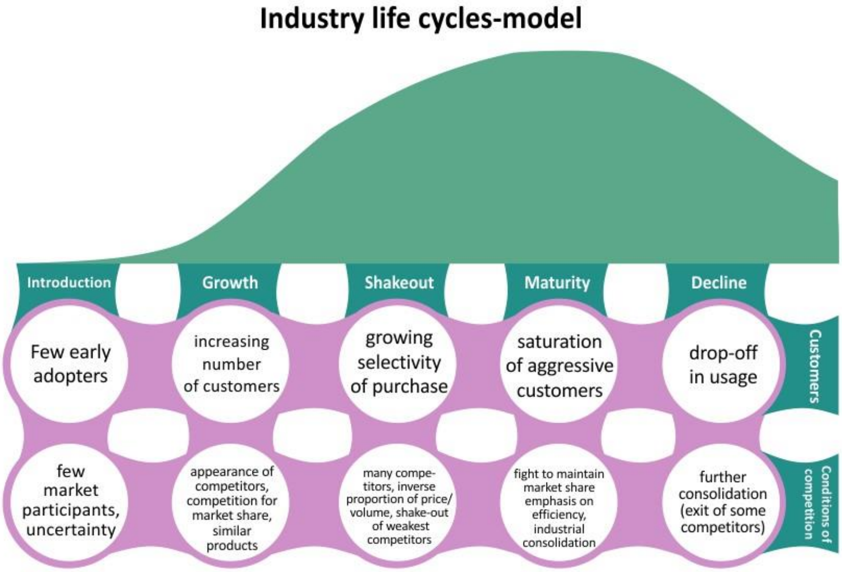
Suppliers have a considerable impact on the life of a business since the quality of the new product produced largely depends on the quality of their products. A possible delay can significantly deteriorate the market chances of the business dependent on them. The price of the transported primary material and equipment influences the minimum level of the price of the new product.

The bargain powers of a supplier group are big if:

1. the industry is dominated by few companies and is more strongly concentrated than the industry which sells its products.
2. it does not have to be afraid that substitute products are meant to be purchased to the industry.
3. the industry is not a considerable consumer of the transport group.
4. the product of the suppliers is an important component of the customers' activity.
5. the customers have differentiated products and the built- in switching cost is considerable.
6. the suppliers can threat with the forward integration worthy of credit.

3.2.3.2. Industry life cycle-model

The industry life cycle model[17] was outlined by Dietger Hahn and Bernard Taylor. The industry life cycle model is similar to the product life-cycle curve.



11. ábra: Industry life cycle model

The model above[18] shows how the features of an industry change from its entry to its decline. The features measured involve the number of customers as well as the competition conditions, such as the number of competitive companies and the character of the competition. The life cycle model differentiates five different phases.

At the phase of **introduction** the industry under formation still has new, considerable innovative contents. There are few participants on both sides (the side of demand and supply) on the market, competition is not significant.

At the phase of **growth** the number of participants is increasing (increases at an increasing rate) the first, fast reacting, innovative competitors appear and competition starts.

At the phase of **shakeout** turnover and the number of participants is already increasing at a decreasing rate. The products and services as

[17] D. Hahn, B. Taylor: Strategische Unternehmungsplanung - Strategische Unternehmungsführung Physica-Verlag, Heidelberg, 1999, 9. átdolgozás. Aufl. 2006

[18] Balaton K. – Tari E.: Stratégiai és üzleti tervezés Aula Kiadó Budapest 2007. 50. o.

well as the producers themselves are differentiated, competition is strong, the less competitive businesses will be ousted from the market.

At the phase of **maturity** there are a lot of conscious and aggressive customers on the market who force out decreasing prices, higher and higher quality and the increasing range of services. It is a competition for blood to keep the gained market share. A possible tool for staying in competition is increasing the efficiency of the company.

At the phase of **decline** the size of industry is growing narrow, customers are looking for new, alternative solutions, and it results in the decrease of turnover. Innovative companies are trying to find new possibilities by structure change, the ones lagging behind are attempting to take advantage of customers' need still available, and then leave the market.

3.2.4 Direct operational environment

While analysing the direct operational environment, we examine the business partners of a company.

The strategic map and strategic group-analysis examine competitors while the consumer-value analysis examines customers. By means of the latter, a strategic table used for competitor-analysis can be created.

3.2.4.1. Analysis of strategic groups. Strategic map

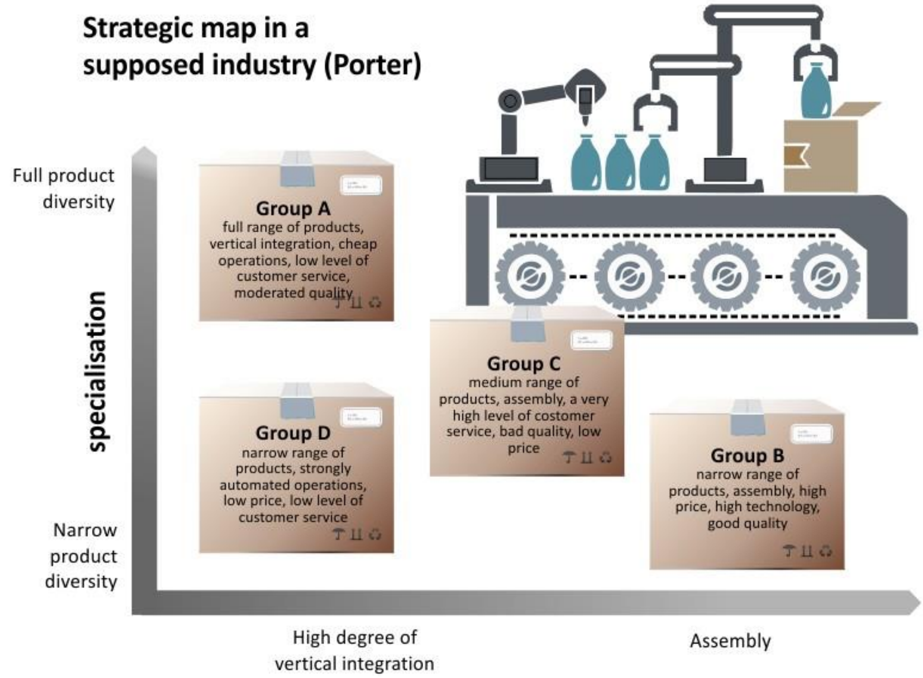
A strategic group is a group of companies of an industry whose members follow the same or a similar strategy, and they react to the opportunities and threats of the market by serving the same market segments and using roughly the same resources and means , consequently, in a similar way[19].

In Porter's view, a strategic group is an examination tool assisting structural analysis. It represents a kind of a middle level between when the industry is regarded it its whole and when every single company is observed separately.

Porter illustrated the analysis of strategic group in a supposed industry in the following way[20]:

[19] Balaton K. – Tari E.: Stratégiai és üzleti tervezés Aula Kiadó Budapest 2007. 53. o.

[20] Michael E. Porter: Versenystratégia Akadémiai Kiadó Budapest 2006. 137. o.



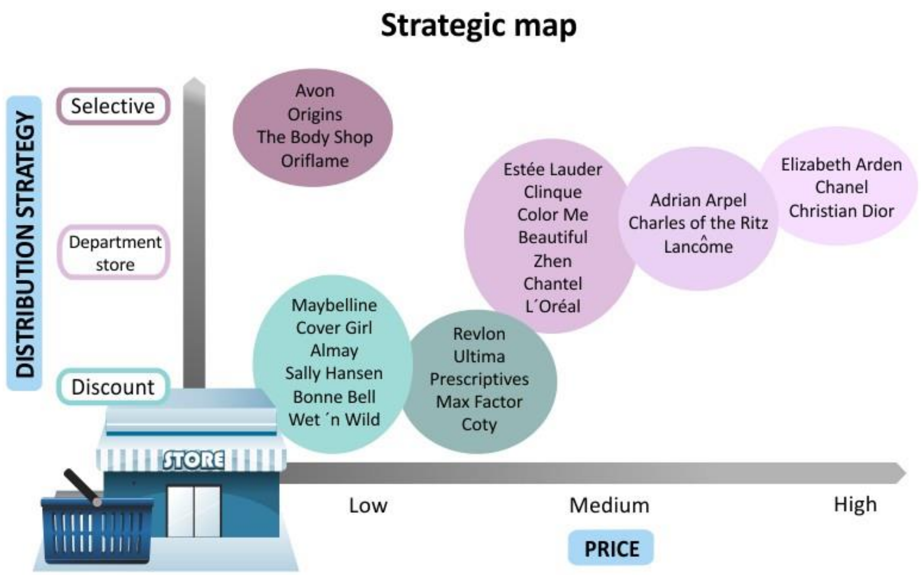
12. ábra: Strategic groups in a supposed industry

The strategic map is derived from the strategic goal system and demonstrates by means of what factors a company wishes to gain success on the market meeting the expectations of the owners.

A strategic map illustrates the company's position in relation to its competitors on a two-dimensional map. The two dimensions mean the two most important paramaters from the point of view the company.

One example for the strategic map[21]:

[21] Balaton K. – Tari E.: Stratégiai és üzleti tervezés Aula Kiadó Budapest 2007. 54. o.



13. ábra: Strategic groups in the cosmetic industry

However, we should be very careful when we determine strategic groups and plan strategy on the basis if it since we can make mistakes here as well.

The basic mistakes made when selecting competitors are as follows:

– At selection two much emphasis is laid on the available and well-known competitors and little attention is paid to the competitors just present on the market or the ones wishing to enter.
– Too much emphasis is laid on the biggest competitors and the dynamically increasing, but still small competitors are neglected.
– The businesses of other geographical regions are not taken into consideration although their effect will appear sooner or later, too.
– During planning it is assumed that competitors will behave similarly as they did in the past.
– The change of competitors' strategy is misinterpreted, and thus wrong estimation will be given for the future.
– The competitors' financial situation and market position are overemphasised, so a more cautious or bolder strategy than necessary will be made.

– During planning attention will be paid only to how to outwit competitors and consumers and the actual needs of consumers will be neglected.

3.2.4.2. Consumer value analysis and strategic table

The aim of consumers' value analysis is for a company to get acquainted with the real needs of consumers buying its products. It breaks down products onto parts, services onto functions, and examines what exactly represents value for the customer and what can be neglected. The necessary steps of value analysis are the following:

1. First we must determine the possible characteristics of the product as well as the related services which represent an influencing factor when customers make a decision to buy the product.
2. While analysing customers' opinions, we must assess the actual effect of particular factors in their decision.
3. Comparing the products of a company and those of its competitors, we must examine to what extent they satisfy consumer's needs.
4. It must be investigated whether it is possible to introduce a new type of product or service which is different from industry traditions and still generates appropriate turnover.

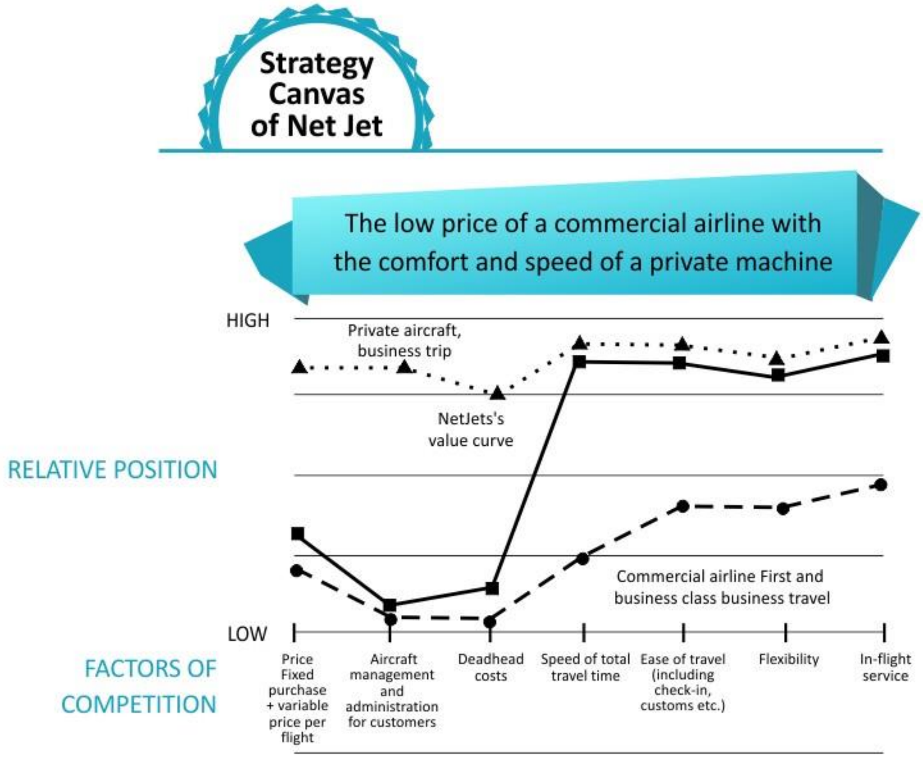
During value analysis it is necessary to examine parameters such as price, packaging, prestige, quickness, comfort, which are factors that always depend on the unique character of the product, and thus they cannot be generally determined.

If you managed to determine the factors representing value for consumers, you can assess the level of your own business along these parameters, and you can compare them with that of competitors or industry average. The strategic table is meant to illustrate this.

The strategic table is a diagnostic tool which shows how a company performs in terms of the factors influencing consumers' decision, compared with competitors or the industry average.

The figure below shows the strategic table of a business[22].

[22] W. C. Kim – R. Mauborgne: Blue Oceans Strategy Harvard Business Review Press; 1 edition 2005



14. ábra: The Strategy Canvas of Net Jets

Analysing competitors involves four primary factors:

1. The present strategy of the competitor
2. Future aims of the competitor
3. The capabilities and resources of the competitor
4. Suppositions related to the competitor.

The following questions must be answered during analysis:

- Is the competitor satisfied with his/her present position?
- What steps or measures is the competitor going to take?
- Where is the competitor vulnerable?
- What triggers the biggest and more efficient revenge on the part of the competitor?

The methods of environment analysis described above make it possible to provide a basis for formulating the goals related to the future and for making strategy. The next step is, however, the examination of the own resources of the business, which will be discussed in the next lesson.

3.3 SUMMARY, QUESTIONS

3.3.1 Summary

In this chapter the factors surrounding the business and the ones influencing its activities, i.e. the elements of the external environment were outlined. Environment was interpreted at three levels:

1. Macro-environment
2. Industry environment
3. Operational environment

The three levels require different analysing methods.

The methods applied for analysing the macro-environment are as follows:

1. the PESTEL-analysis
2. the STEEPLE-analysis
3. the Diamond-model

For analysing the industry environment the methods below were used:

1. Porter's five forces-model
2. Industry life cycles-model

The analysis of the immediate operational environment can be done by using the following methods:

1. Strategic group analysis, strategic map
2. Consumers' value analysis

By using the methods described above, you can get acquainted with the state, the change of the environment of a business and the impact of these elements on the business. Following this, the plan for the next period can be prepared by means of examining the inner capacities of the company.

3.3.2 Questions for self-assessment

1. How is the environment of a company interpreted?
2. What is the goal of environment analysis? What is it used for?
3. On the basis of what characteristics are the various environment types of a company determined? What do these features mean?
4. What environment types do you know according to complexity and dynamism, and what methods can they be analysed/planned by?
5. What does micro-environment refer to and what methods can it be analysed by?
6. Describe the PESTEL-analysis.
7. Describe the STEEPLE-analysis.
8. Explain the Diamond-model. Who was it created by?
9. Define the concept of industry.
10. What does competitive strategy mean?
11. Enumerate the steps of analysing industry.
12. Describe Porter's five forces-model. Describe the components of each category.
13. Describe the industry life cycles-model. Characterise briefly its particular categories.
14. What does the strategic group mean from the point of view of a business?
15. What does the strategic map refer to? What is its aim? What are the typical mistakes made while a strategic map is prepared?
16. What does consumers' value analysis refer to?
17. Explain the main steps of doing a consumers' value analysis
18. What is the relationship between consumers' value analysis and the strategic table?

3.3.3 Practice tests

1. Practice of concepts: Multiple-choice test (there is only one correct answer)

1. The environment of the company is

a, what surrounds the company.
b, the factors that have an impact on the company.
c, means its natural environment.
d, means the time horizon.

2. The goal of environment analysis,
a, to assess the factors affecting the company, their consequences
b, to assess the natural resources available
c, to examine what the company has an impact on
d, to limit our activities.

3. The transparent environment
a, produces small, calculable changes.
b, is planned by simulation.
c, can be modelled easily.
d, prognosis by experts must be taken into consideration while planning it.

4. When examining macro-environment, we analyse
a, consumers' expectation of the product.
b, the behaviour of competitors.
c, the political, legal system.
d, the inner capacities of the company.

5. In Porter's five forces-model we don't examine threat of substitute products
b, the concentration of customers
c, the capital need for entry into the market
d, the operation of economic system

2. Describe the environment of the company. Fill in the figure below

3. On the basis of complexity and dynamism what environment types do you know?
1. ………………………………… environment
2. ………………………………… environment
3. ………………………………… environment
4. ………………………………… environment

4. Compare the fields of the PESTEL- and STEEPLE-analysis.

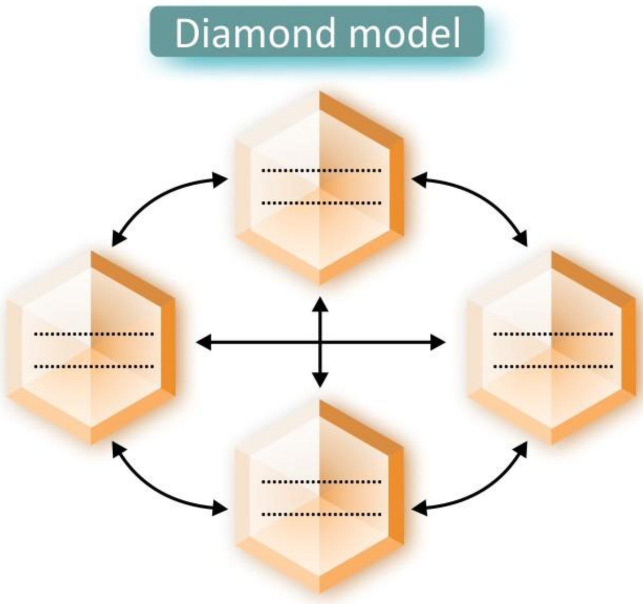
P: ………………………………	S: ………………………………
E: ………………………………	T: ………………………………
S: ………………………………	E: ………………………………
T: ………………………………	E: ………………………………
E: ………………………………	P: ………………………………
L: ………………………………	L: ………………………………
	E: ………………………………

- P – political
- E – economic
- S – social
- T – technological
- E – environmental
- L – legal

- S - social
- T - technological
- E - economic
- E – environmental protection
- P - political
- L - legal
- E – educational –development of human resources

5. What does the Diamond-model analyse? What factors does it take into consideration? Complete the figure below.

What does it analyse? ………………………………………………



The Diamond model of Porter

6. What are the factors examined by the Porter's five forces-model? Choose the right answers. (There are several good answers). For a wrong answer a point will be reduced from your score.)

a, inflation
b, natural environment
c, the opportunities of competitors
d, economic serial size
e, substitute products
f, industry life cycle
g, differentiation of the product available in the industry
h, strategic group
i, built-in switching cost

7. True-false questions

1. During consumers' value analysis by comparing the products of the company with those of the competitors, we must examine to what extent they satisfy consumers' needs.

2. The strategic table is a diagnostic tool which shows how a company can adapt to the legal system.

3. Dynamism means in what complex, multi-factored environment the company works.

4. In the case of complex environment the method of planning is scenario-writing.

5. The analysis of inflation and unemployment is part of the analysis of macro-environment.

6. The importance of scriptwriting is that starting from the current position we plan the expected changes in such a way that we prepare a realistic version.

7. Scenario-preparing outlines the prospects for the future by means of trend-extrapolation.

8. In the Porter's five forces-model cost disadvantages independent of size must be taken into consideration.

8. Match the characteristics and the model in which they are applied

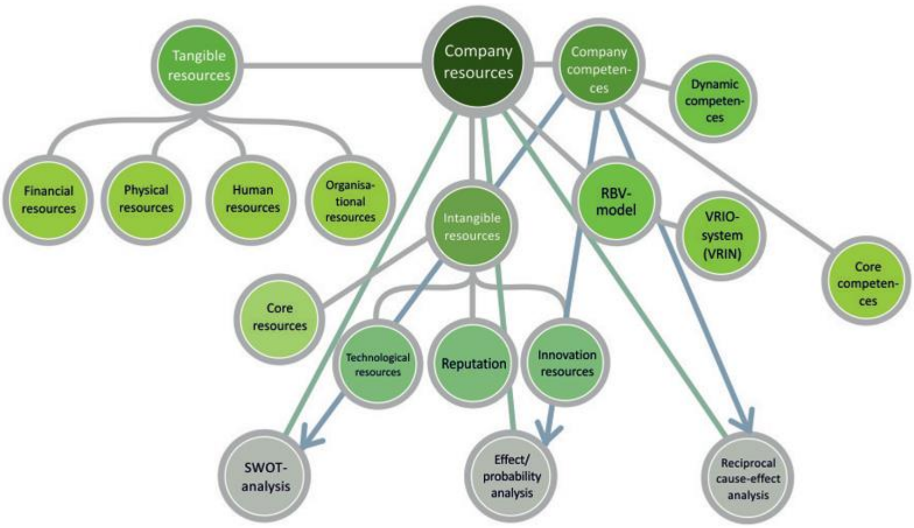
Model	Characteristics
(1) PESTEL-analysis	(a) analysing company strategy and the context of competition
(2) Porter's five forces-model	(b) examination of the real needs of consumers
(3) Industry life cycles-model	(c) analysis of natural environment
(4) Consumers' value analysis	(d) analysis of capital need
(5) Strategic group-analysis	(e) the rate of sales growth
(6) Strategic map	(f) the position of the company compared to the competitors
(7) STEEPLE-analysis	(g)analysis of socio-cultural environment
(8) Diamond-model	(h) analysis of competitors following a similar strategy

4. THE INTERNAL ENVIRONMENT OF THE COMPANY (G. SOÓS)

4.1 OBJECTIVES AND COMPETENCES

In this lesson students will get acquainted with what is meant by the internal resources of a company, their types and classification possibilities. They will be able to make a distinction between resources and capabilities. They will recognise and will be able to apply the requirements for resources. For any given company they will be able to apply the main methods of analysing resources, to connect them with the strategy that can be applied, and to make suggestions for company management regarding the principles of how to prepare the strategy in term of resources.

4.2 COURSE MATERIAL



15. ábra: Concept map

4.2.1 The methods of analysing resources

In order to formulate company strategy, to analyse the present situation and to make plans for the future, it is crucial to assess and evaluate the internal competences and resources of the company, and to estimate the impact of future processes on the company.

Resources refer to inputs for the value creating processes of a company interpreted in a broader sense.[23]

One method of assessing the internal resources of a company is the so called “resource-based view” (RBV). In this approach resources are analysed as the key of company processes, which are the means of achieving comparative advantages[24] . The starting point of the theory is that the resources must be found within the company (instead of analysing the external environment or rather together with it) which means a competitive advantage of the competitors for the company.

Resources are divided into two primary groups by this method.

1. **Tangible resources**: are of physical nature, visible (e.g. capital, land, buildings, plantations, equipment, facilities),
2. **Intangible resources**: are of non-physical nature, invisible (e.g. culture, knowledge, trade-name, reputation and intellectual property, such as copyright, patent, trademark, production and business secret).

A good example for the resources above is Google. The value of its tangible resources (buildings, facilities, server farms) while the intangible resources (e.g. trade-name) amount to about 100 billion dollars, being the second in the world, preceded only by Apple.

Comparative advantage can come rather from intangible resources, which are much more difficult to be acquired and created.

Resources are evaluated in the VRIO-system[25][26]:

V – valuable
R – rare

[23] Balaton K. – Tari E.: Stratégiai és üzleti tervezés Aula Kiadó Budapest, 2007. p 59

[24] Comparative advantages (David Ricardo): between two contries it arises from the fact that in particular countries differ the natural factors, work productivity, the level of scientific, technological knowledge and other production factors (e.g.level of innovation), and thus a given country can produce certain product(s) compared to another/other country/countries at a lower cost. Such products have a comparative advantage of the other country(countries). Ricardo provided a basis for the theory of comparative advantages, but since then the definition of comparative advantages has been modified by many other scholars.

[25] The theory was published by J. B Barney as VRIN-systemrendszerként in 1991 (”N” referred to ”non-suitable”category). It was extended by Black-Boal in1994, so it became VRIO-model. (Balaton-Tari 2007).

[26] J. B. Barney: Strategic Factor Markets: Expectations, Luck and Business Strategy. Management Science; 32, (10), pp. 1231–1241.

I – costly to imitate
O - organize to capture the value of the resource

If the resource has the values above (primarily heterogeneous and immobile), it means competitive advantage for the business in the short run. Time span depends on how unique the resource is, how long it takes and how much it costs to imitate it. Of course, success is also determined by whether the company recognises this resource and its advantages, and whether it can make use of it properly.

The resources which are the most important in the processes of a company and are indispensable for its success are core resources. After identifying resources, the steps of evaluation are as follows:

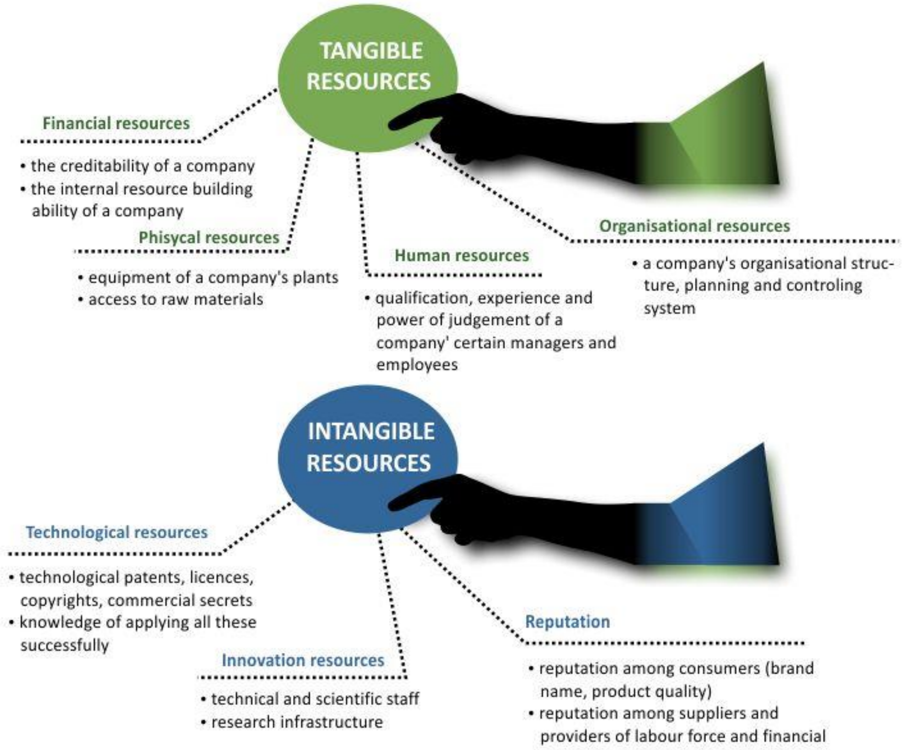
1. What would happen if the company didn't invest into acquiring and developing resources any more?
2. How crucial is this resource to achieve competitive advantage at present and in the future?
3. What is needed to keep this key competence and for the company to be able to make use of it in a broader industry?
4. What kind of further market possibilities can be created by the resource in the future?

If the resource influenced the expected results of the business considerably on the basis of all these, it could be regarded as **key-resource**. In this case these competences get into the centre of the strategic plan.

4.2.2 Classification of resources[27]

As it is was shown by the RBV-method in the first part, resources can be classified into two groups. Grouping is shown by the figure below.

[27] Balaton K. – Tari E.: Stratégiai és üzleti tervezés Aula Kiadó Budapest, 2007. p 60-65. alapján



16. ábra: Classification of resources

4.2.2.1. Material (tangible) resources

Material resources are tangible, identifiable and can be measured easily.

Financial resources are properties affecting company strategy which influence the financing capability of the company. Such are for example, cash, other long-term and short-term financial means (e.g. credits, loans, leasing), operating capital and liquidity, etc.

Physical resources include primarily the properties, machinery, equipment, raw materials that can be bought and produced, auxiliary material and facilities.

Human resources comprise the knowledge, experience, capabilities of company managers and employees. A crucial factor is motivation without which the above skills and capabilities are not utilized. The role of human resources increases considerably by how innovation oriented an industry is.

Organisational resources refer to the formal organisational structure of the company. It is influenced by the sub- and superordinate relationship, division of tasks and responsibilities, coordination mechanisms and managing style. Similarly to human resources, the character of the organisational resources determines to what extent the resources available can be utilized in an organisation, and how they can contribute to the success of the business.

4.2.2.2. Non-material (intangible) resources

Technological resources, which contribute to the uniqueness of the products, services and technologies of a company, make it difficult for competitors to imitate and follow them. Such are patents, licences, know-hows, trade-marks, which besides making the product unique help customers to identify them, and arouse trust in consumers, and thus making the product more marketable.

Innovation resources manifest themselves in the development level of research infrastructure (size of experimental and research laboratories, equipment, standard, the number, qualification, uniqueness of researchers. In the case of this factor it is crucial what academy relationships the business fosters, and thus what access it has to scientific resources, and how it can utilize them to achieve success.

Reputation comprises all the opinions about the company, its products and services, which can be positive or negative. An important task of management is to form and improve reputation. Reputation on the side of input (customers) and on the side of output (suppliers) considerably influence the success of a company, which manifests itself primarily in the product quality and the number of sales (of course besides many other factors).

It is crucial to assess the availability of the above resources-groups. However, if the company owns a given resource, it does not necessarily mean that it contributes to its success. While examining resources, it must also be touched upon how the company can utilize its available resources.

4.2.2.3. Competence

Competence[28] refers to the suitability of some resource combination to carry out a task or activity in an integrated operation.

The so called **core competences** have the following properties:

[28] Balaton K. – Tari E.: Stratégiai és üzleti tervezés Aula Kiadó Budapest, 2007. p 64-65. alapján

- provide access to the various markets,
- contribute considerably to the value created for customers,
- are unique, difficult to imitate,
- unique capabilities and technologies,
- non-product specific (can be applied in several products), represent knowledge and expertise, which develop by time.

Dynamic competences are the definite processes of a company which achieve market changes by integrating, reconfiguring, organizing and selling resources, namely they enable the company to adapt to changes. Dynamic competences are such organisational and strategic routines that create new resource-configurations while new markets appear, get combined, separated or stop.[29]

One method of grouping resources and competences:

17. ábra: Grouping resources and competences[30]

[29] Balaton K. – Tari E.: Stratégiai és üzleti tervezés Aula Kiadó Budapest, 2007. p 65

[30] Bartek-Lesi M.-Bartók I.-Czakó E.-Gáspár J.-Könczöl E.-Pecze K.: Vállalati stratégia Alinea Kiadó Budapest 2007. pv115

4.2.3 Resource-based strategy view[31]

This method starts from available the resources. The evaluation of the revealed resources provides a basis for formulating and compiling the later strategy. In this view, five steps are necessary to base strategy:

1. **Identifying company resources**: what resources the business has, how they contribute to the strengths and competitiveness of the company.
2. **Identifying core competences**: which competences mean a greater competitive advantage relative to competitors.
3. **Examining the income generating capabilities of resources and competences**: the degree of contribution of resources towards company results.
4. **Choosing strategy**: choosing the strategy which exploits the chosen resources more effectively than competitors, and thus better competitive advantage can be gained by them.
5. **Identifying competency-gaps**: identifying such "gaps" which emerge as a deficiency between the resources that are needed for the state planned in the strategy and the ones which are available at present.

4.2.4 SWOT-analysis

The SWOT-analysis is a widely used method for analysing the impact factors of a company's resources and the external environment together. SWOT is an acronym which is composed of the initials of the English words for the categories.

S – Strengths
W – Weaknesses
O – Opportunities
T – Threats

While doing the SWOT-analysis, we evaluate *the internal resources of the company* (**S**trengths and **W**eaknesses) and *the impact factors of the external environment* (**O**pportunities, **T**hreats).

Strengths: the internal resources and competences which mean a competitive advantage against competitors. Market success can be

[31] Balaton K. – Tari E.: Stratégiai és üzleti tervezés Aula Kiadó Budapest, 2007. p 65-66 alapján

achieved based on these factors. Examples for it can be a patent available, technology and special knowledge (software), etc.

Weaknesses: company resources and competences which can mean competitive disadvantage, which companies must pay attention to continuously, developing them or – if improvement is not possible- eliminating them play an important role in achieving success. Such are, for example, weak innovation capability, inappropriate raw material source and out-of-date infrastructure, etc.

Opportunities: external influencing factors and expected changes of the environment that can contribute to the future success of a company, and making use and integrating them into strategy can lead to competitive advantage. Examples for it are the appearance of a new regulation or support, improving bargaining powers and considerable innovation potential, etc.

Threats: an unexpected unfavourable factor in a company's environment that can hinder the strategic plan and achieving company success. Examples for it are entry of a new market participant, deteriorating bargaining powers and stricter regulation, etc.

The possible influencing factors are summarised in a matrix.

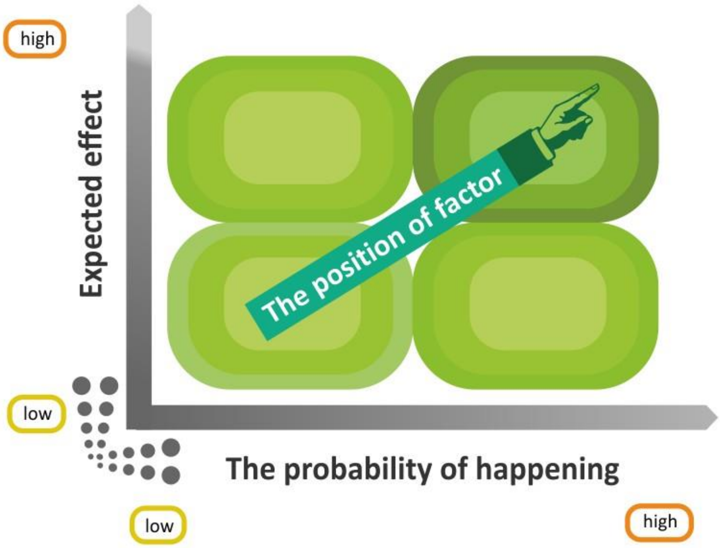
If you are interested in it, you can read the Coca Cola SWOT-analysis that can be found in the database of Euromonitor. http://www.euromonitor.com/medialibrary/PDF/Coca-Cola-Co_SWOT_Analysis.pdf

After revealing the opportunities and threats, it is worth continuing to analyse these categories and factors with respect to what impact they are expected to have on the life and strategy of the company.

4.2.5 Effect/probability-analysis

The Effect/probability analysis is meant for the further categorisation of the external factors of SWOT. Environmental factors must be examined along two dimensions. On the one hand, it must be estimated what the likelihood is that the threat or opportunity will happen, on the other hand, it must be assessed that if it should happen, what impact it will have on the company.

Expected effect



18. ábra: Effect/Probability-analysis

4.2.6 The connection of SWOT-analysis and strategy

The so called r**eciprocal cause-effect matrix** shows what elements of market strategy must be taken into consideration when certain influencing factors are dominant. Accordingly, four primary strategy-types can be distinguished.

19. ábra: Reciprocal cause-effect matrix

Attack strategy: In the case of a strong market position and considerable competitive advantage an aggressive strategy is needed to make use of the emerging opportunities.

Development strategy: The aim is to make a better use of the opportunities while reducing weaknesses.

Defend strategy: the company must be prepared for considerable future threats, such factors must be eliminated by making use of strengths.

Prevent strategy: survival strategy is based on improving competitive disadvantages due to weaknesses and preparing for threats.

4.3 SUMMARY, QUESTIONS

4.3.1 Summary

Besides analysing the impacts of the external environment, the inner resources and competencies of a business must also be taken into consideration in order to create a successful strategy. The value creating process of the company will be realised by means of resources, and the company can achieve a competitive advantage against competitors by them.

Resources can be grouped into two categories: tangible and intangible resources. The former comprise financial, physical, human and organisational resources while the latter refer to technological, innovative resources and reputation.

Assessing resources according to the VRIO-system, we can determine which of them mean a comparative advantage for the business. In addition to resources, the company’s competences must also be considered for creating a future strategy. Resource-based strategy view prepares strategic planning by evaluating resources and competences in five steps. The commonly used method meant to assess resources and the impact of the environment together is the SWOT analysis, which evaluates the internal capacities of the company (strengths and weaknesses) as well as the environmental impacts (opportunities and threats). In the case of the latter factors the effect/probability makes further analysis possible. On the basis of the results of the SWOT-analysis, it can be determined what basic strategy is to be followed by the company.

4.3.2 Questions for self-assessment

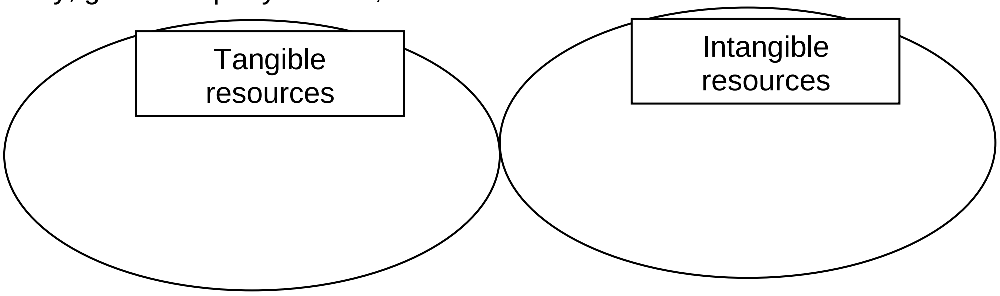
1. How would you define the resources of the company?
2. Why is important to examine and assess resources?
3. What does the RBV-method mean? What is it aim?
4. What basic groups are resources broken into by the RBV-method?
5. What is the VRIO-analysis used for? What requirements are formulated for the resources?
6. How can the core resources be selected from the others?
7. Describe the components of the two main groups of resources. Give some examples for each category.
8. What is meant by competence of a company?
9. What is meant by core competence? How ca the most important core competences be selected from competences?
10. What does dynamic capability mean?
11. How can we group resources and competences together?
12. Explain the steps of resource-based strategy view.
13. What is analysed by the SWOT-analysis? Give an example for each category of the SWOT-analysis.
14. What is examined by the Effect/probability-matrix?

15. What does the Reciprocal cause-effect matrix show?
16. What basic strategies exist according to the Reciprocal cause-effect matrix?

4.3.3 Practice tests

1. Put the resources below into the right group.

big warehouse, lorry, law qualification of manager, patent, long term investment credit, stocks, democratic management style, know how, research instruments of high standard, positive market brand, stable liquidity, good company morale, fuel base.



2. Choose the characteristics by which a competence can be qualified as a core competence. (There are several good answers).

a) contributes to achieving good company morale,
b) autocratic management style,
c) is easy to imitate,
e) extraordinary, unique technologies,
f) the capability of imitating and following competitors quickly,
g) brand building capability,
h) competence that can be used in the case of any product,
I) has market influencing effect,
j) considerably influences values created for customers,
k) provide access to various markets.

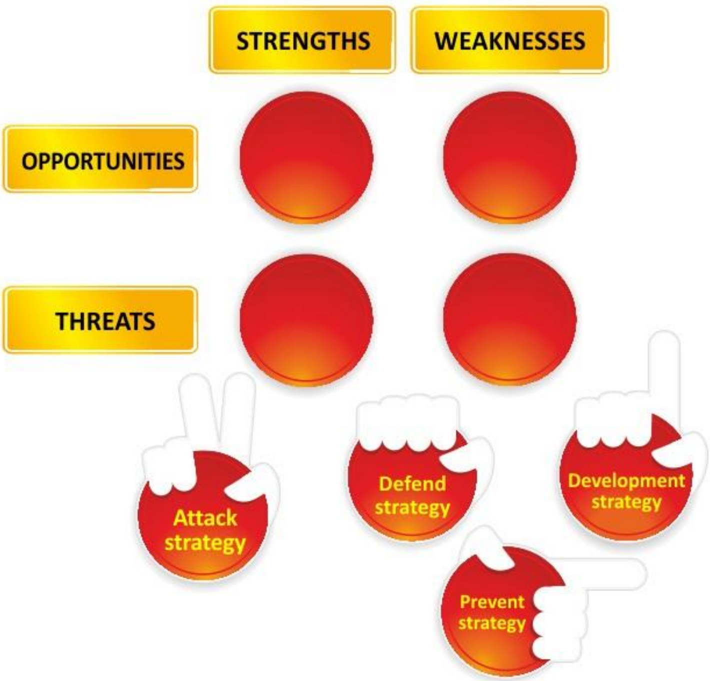
3. Name the categories of the SWOT-analysis below. Put the characteristics below into the group.

1. …………………………………	2. …………………………..

3. …………………………………	4. …………………………..

a) stable market position
b) inflation is predicted to decrease in the next year
c) a new competitor enters the market
d) the quality of raw materials deteriorates
e) small marketing-budget
f) more and more warranty repairs
g) strong, positive brand
h) sources for tendering can be expected in the industry
i) the increase of credit rates is expected
j) the sales of our strategic products exceed those of our main competitor's
k) narrow market capacity
l) the Japanese market is interested in the products of the industry
m) up-to-date quality-management system and trade mark certification
n) inappropriate liquidity
o) more and more cheap imitations appears on the market as a competitor of our strategic product
p) increasing need on the part of training institution to place trainees at the business.

4. Put the strategies below into the right place in the figure.
11_04_K06: Nyolctényezős SWOT



5. Decide whether the following statements are true (T) or false (F).

1. The resource-based approach examines the internal resources of a company.
2. A tangible resource is, for example, trademark.
3. Comparative advantage derives more frequently from intangible resources.
4. Products which are easier to imitate means long term comparative advantage relative to competitors.
5. An important characteristic of core competences is that they are product specific.
6. Dynamic capabilities are organisational and strategic routines which create new resource-configurations while new markets emerge.
7. The SWOT-analysis a widely used method for analysing impact factors of the external environment.
8. In the SWOT-analysis strengths are the internal resources of the business which mean a competitive advantage relative to competitors.
9. The effect/probability analysis offers four basic strategies for strategic planning.

10. According to the SWOT-analysis, in the defend strategy the aim is to make a better use of the opportunities besides reducing weaknesses.

6. Put the steps of the resource-based strategy view into the correct order.

1. …
2. …
3. …
4. …
5. …

Selecting strategy
Identifying competency-gaps
Identifying the company's resources
Examining the income generating capabilities of the resources and competences

7. Match the examples and corresponding resource-categories.

1) Financial resource	a) purchased goods
2) Human resource	b) task-distribution
3) Physical resource	c) licence
4) Technological resource	d) relationship with the academy
5) Organisational resource	e) established consumers' opinions
6) Reputation	f) liquidity
7) Innovative resource	g) experience

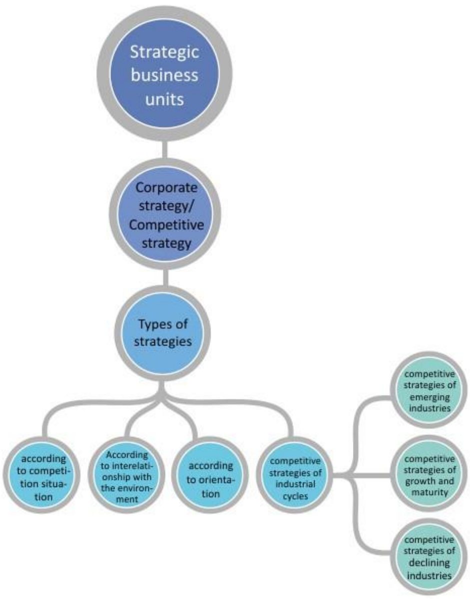
5. COMPETITION STRATEGIES (G. SOÓS)

5.1 OBJECTIVES AND COMPETENCES

The aim of this lesson is to make students familiar with the primary factors which determine what strategic goals a company should implement by what means as well as what strategy it should choose. As the topic has been widely discussed in the economics literature, without the expectation of perfection only some of the most important aspects of the topic will be described. We find it important to make students aware of the fact that a company must not only get to know its environment but it must also consider several restricting factors when it decides on a strategy regarded to be the best in a given situation.

By acquiring the material of this lesson, students will be able to determine major factors for the company to consider and to make suggestions for the management about creating strategy. They will know the barriers to the major strategies that can be chosen, as well as the impact of barriers on planning and on the consequences of certain decisions.

5.2 COURSE MATERIAL



20. ábra: Concept map

5.2.1 Strategy

After assessing the resources and the environment, the business can start to create plans for the future, to prepare strategy.

Corporate strategy deals with the comprehensive goals, the organisational structure of a company and the relationship between certain areas of business operation and the centre.[32]

Corporate strategy is interpreted and prepared on three levels:

- corporate level
- business unit level
- functional or departmental level

Strategic business units are such separable areas of business within the company which represent well-definable product-market combinations, and their competition position and effeciency can be assessed separately.[33]

The aim of creating a strategy is to enable a company to increase its competitiveness, and thus to gain greater and greater market share. Competition strategy is the combination of the goals for which the firm is striving and the means or policies with which it seeks to get there.[34].

[32] Chikán A.: Bevezetés a vállalatgazdaságtanba Aula Kiadó Budapest 2006. p 281 It must be pointed out there is no generally agreed defintion of strategy in the literature, thus it has several others versions. In this course, you can find a definition which approaches it from one aspect but it creates a proper foundation for the topic.

[33] Chikán A.: Vállalatgazdaságtan Aula Kiadó Budapest 2003. p 479

[34] M. E. Porter: Versenystratégia Akadémiai Kiadó Budapest 2006. p 23

21. ábra: The wheel of competitive strategy[35]

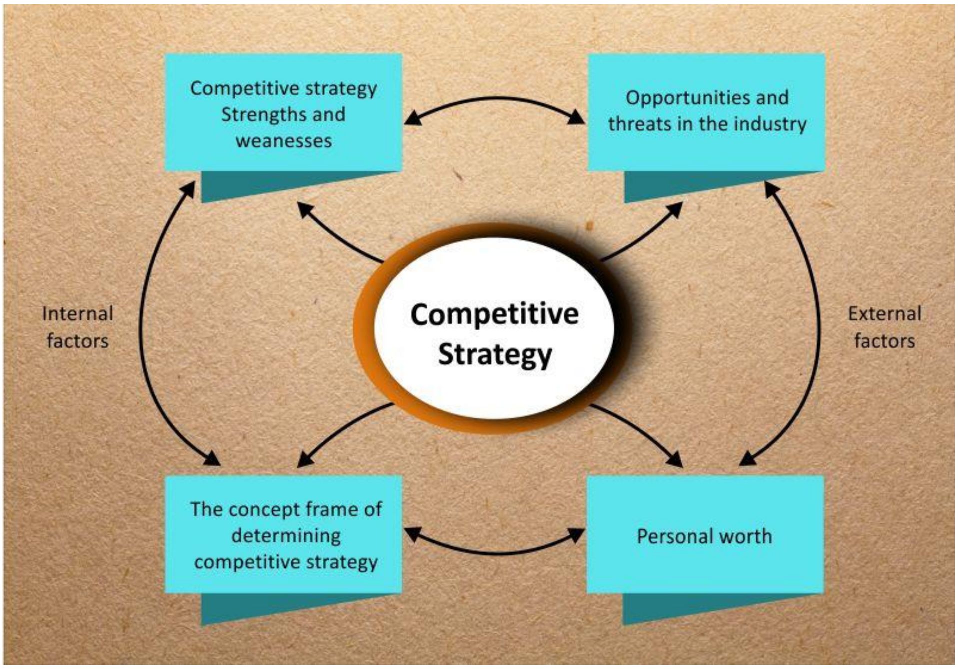
The figure above – the wheel of competitive strategy –shows the key areas of corporate strategy, as well as that for the success of competitive strategy, close cooperation between these areas is needed.

”The spokes of the wheel are the key operating policies with which the firm is seeking to achieve these goals.”[36]

Porter summarised the concept frame of preparing corporate strategy. In his view, every strategy is competitive strategy since the task of management is to make sure that the company is successful in the long run relative to its competitors. Porter’s visual representation of competitive strategy shows that when formulating a firm’s competitive strategy, four key factors must be considered, and these will determine the upper limits of what is can reasonably accomplish.

[35] M. E. Porter: Versenystratégia Akadémiai Kiadó Budapest 2006. p 24

[36] M. E. Porter: Versenystratégia Akadémiai Kiadó Budapest 2006. p 23



22. ábra: The concept frame of determining competitive strategy[37]

5.2.2 Types of strategy[38]

Corporate strategies can be grouped by several methods. Some of them will be outlined below.

5.2.2.1. Strategy types according to the competitive situation

According to Porter there are two primary ways of achieving competitive advantage:

- a cheap production budget-structure makes it possible to appear on the market with low prices.
- the products have unique characteristics, which can be a means to convince customers to buy them.

[37] M. E. Porter: Versenystratégia Akadémiai Kiadó Budapest 2006. p 25

[38] Chikán A.: Vállalatgazdaságtan Aula Kiadó Budapest 2003 3.2. fejezet alapján.

– When creating strategy, the character of the target market must also be taken into consideration, and based on this we can choose between four primary competitive strategies.

23. ábra: Competition strategies according to the competitive situation[39]

Cost leadership: The company appears with a wide range of products produced at a low budget and with low prices on the market, even in more than one industry at a time, and thus it can gain a considerable market share.

Differentiation: The product the company offers is somehow unique, and therefore customers are willing to pay more for it. The uniqueness of its product makes it easy for consumers to differentiate it from that of their competitors'.

Concentration: Both previous strategies have a narrow-focus version, which means they target only a narrow segment of the market. Accordingly, the two types are:

Differentiation focus: If competitors underachieve in reaching the same segment of target market, then the basis of competitive strategy is to satisfy customer demand better

Low-cost focus: If competitors underachieve in satisfying customers' needs, then a more optimal budgeting can provide competitive advantage for the business.

[39] Chikán A.: Vállalatgazdaságtan Aula Kiadó Budapest 2003 p 499

5.2.2.2. Types of strategy according to the response to environmental influences

The basis of strategy classification is how the business can react to the changes of the environment, both in a reactive and a proactive way.

Depending on the stability of the environment and the company's reaction to changes, four basic types of strategy can be distinguished:

Defenders operate in a narrow segment of **a** stable environment**,** to which they have established a stable organisational form. In the narrow segment of market they are competitive and their primary goal is to maintain competiveness. Besides, in order to defend their market position, they make their production more efficient and apply more efficient organisational methods.

Prospectors adapt well to the dynamic change of the environment. They are striving to create new market possibilities with new products. These participants are characterised by wide operating segments and a wide range of varied technologies, thus always seeking new innovations. However, their striving for constant renewal has a negative influence on efficiency, and in this field their competitors can gain an advantage over them.

A**nalysers** try to combine the advantages of the previous two types. Besides maintaining their current position, they plan new products and to gain new segments of market. They strive to adapt flexibly to the challenges of the environment, but it is important for them to preserve the position that their company has already earned in the markets. Their main goal is growth within the available segment.

Besides the above types, the group of **reactors** can also be mentioned who can often be regarded as "strategic failure companies". These companies are not able to respond properly to the challenges of the environment. The problem is caused either by improper strategy formulation or the wrong choice of tools.

In another method of classification, the possible strategies are examined in the relation of the strength of competitive position and market growth rate.

As can be seen, the methods involve four primary cases. If the company is weak, and its market growth rate is small, the aim can primarily be withdrawal, and to diversify [40]out of its current position by means of considerable innovation, respectively.

[40] Diversification is a category known from the Ansoff-matrix, it means that the company intends to enter entirely new market with a product that has not been sold before.This strategy involves considerable risk for the business.

If the company produces dynamic growth besides its current weak competitive position, it can improve its market position by thinking over the market segment(s) [41]it strives to gain, and the related strategy. Another means of gaining competitive advantage can also be merging with another company operating in the same industry.

If competitive position is strong, but growth is slow, the goal of strategy can be again gaining a new market segment by means of diversification.

If the company has achieved a strong competitive position, and its growth is also dynamic, it is worth concentrating on a well-circumscribed segment of the market, and in order to increase efficiency, vertical integration (integration with companies in a similar field – at the same level of value chain) is set as a goal.

5.2.2.3. Types of strategy according orientation

In terms of the most important participants focused on in a company's activities, strategies can be grouped into three primary types:

The primary goal of **customer-oriented strategies** for a company is to meet customers' needs at such a high level and in such a high quality as possible, with all company activities being subordinated to this aim. The basis of preparing a strategy involves discovering customers' needs, market segmentation, targeting and positioning.

Company-oriented strategies are aimed to enable the company to acquire such high market share, and to achieve such high levels of economic efficiency as possible. In this case, strategic planners start analysing the resources of the company, and concentrate on the function which ensures successful operation and competitive advantage for the company.

Competitor-oriented strategies start with differentiating the company from its competitors. This strategy focuses on a favourable attribute which ensures differentiation, and the primary goal is to develop this.

5.2.3 Competition strategies of industry life-cycles phases[42]

5.2.3.1. Competitive strategies of emerging industries

[41] "Groups of the market showing unique demand characteristics are called segments, the procedure serving to get to know the market, and dividing it into homogeneous parts – making the economic implementation of marketing action possible – is called segmentation." (Bauer-Berács: Marketing)

[42] M. E. Porter: Versenystratégia Akadémiai Kiadó Budapest 2006. 9-13. fejezete alapján

Emerging industries: newly formed or reformed industries that have been created by technological innovations, shifts in relative cost relationships, emergence of new consumers' needs, or other economic and sociological changes that elevate a new product or service to the level of a potentially viable business opportunity. [43]

In an emerging industry there are no established processes, rules, connections, and thus their formation depends on the participants' activity.

Common structural characteristics:

1. **Technological uncertainty**: when new technologies are introduced, it is not known which will be successful, whether they can be developed, whether they will be accepted by customers, and which ones will be suitable for mass production. Thus, long term planning can encounter a lot of difficulties here.

As an alternative of TVs with picture tubes, LCD and plasma technology appeared roughly at the same time. The players of the industry, consumers and the experts of the industry were just speculating about which one will be more accepted in the long run. Initially, plasma TVs were predicted to have a brighter future, but according to sales statistics, LCD TVs became more successful. 95% of the sales of flat screen TVs are of LCD technology. For example, the company PANASONIC finally announced that it would stop manufacturing plasma TVs from 2014. According to analysers, these products will have disappeared from the market by 2016.

2. Strategic uncertainty: as there is no identified "right" strategy, participants try and experiment with different approaches to product/market positioning, marketing as well as with different product configurations or production technologies. Uncertainty is enhanced by the fact that participants have little information about competitors, reliable industry sales and market share data are simply not available which would serve as a basis for planning.

3. High initial costs but steep cost reduction: research costs, small production volume and marketing costs of promoting new products increase the initial costs of new products considerably, especially in the case of technologies with high innovation-content. By sales increasing,

[43] M. E. Porter: Versenystratégia Akadémiai Kiadó Budapest 2006 p 205

the cost per unit[44] decreases. Costs can decrease even more quickly if the profit coming from learning and the profit from reaching an economic serial volume are combined.

4. Embryonic companies and spin-offs: the emerging phase of industry is usually accompanied by the presence of the greatest proportion of newly formed companies. Due to unestablished competition rules, the difficulties of reaching economical serial size, many companies leave the industry or new ones spin off the already established companies. The new spin-offs are often founded by experts spinning off old companies because of the possibility of development.

5. First-time buyers: buyers of the emerging industry's products and services are inherently first-time buyers who like trying out new technologies, and are willing to pay more and take consumers' risk by it. The marketing policy of the company focuses on acquiring market share, and thus a considerable amount of resources and assets must be mobilized to induce customers to try out yet unknown products and technologies.

6. Short time horizon: due to the problems described above, the strategy's goal is to acquire customers and increase demand in the short run.

7. Subsidy: the competing companies in emerging industry and the government as well – if the interests of society require it - are doing their best to make the new industry successful. Thus, early entrants receive subsidies from a variety of government or non-governmental sources if they apply new technologies (e.g. using solar-and geo-thermic energy).

The barriers of early life-cycles for companies:

- technology protected by patent
- little access to distribution channels
- access to appropriate raw materials is difficult
- cost advantages coming from experience are still missing
- the prices of raw materials are increasing
- lack of infrastructure hinders development
- fluctuation of product quality as long as there are no rules
- licencing procedure
- market answers of participants threated by new technologies

[44] The **cost per unit** is commonly derived when a company produces a large number of identical products. The cost is derived from the variable costs and fixed costs incurred by a production process, divided by the number of units produced. cost per unit

Strategic choices in emerging industry:

In emerging industry there are a lot of uncertainty factors, thus formulation of any strategy involves high risks. At the same time, due to these unestablished circumstances, there are a lot of possibilities in it, even the application of new unknown means.

1. Shaping industry structure: as industry structure has not been shaped yet, the company can try to set the rules in areas like product policy, pricing strategy and marketing approach. By these measures, it obviously aims to position itself as a leading market player in the long run.

2. Externalities in industry development: the success of a company operating in emerging industry also depends on the development of the industry although conflicts of interests may arise from it. At the same time, one means of producing market quality and ousting fly-by-night producers from the market can be standardization, which, however, requires new resources , but contributes to the development of the industry and meeting all customers' needs a well as possible. Furthermore, it can be useful to apply means for promoting the whole industry, for example organising professional conferences, improving its image continuously and avoiding strategies of damaging the reputation of competitors.

In emerging industry it is especially important to integrate the few participants in it (e.g. in the form of a cluster[45]), which often causes dilemmas for competitors, as they compete with each other, and thus cooperation along common interests can sometimes run up against difficulties, and it can often be realised only by changing the whole concept.

3. Changing roles of suppliers and distributor: supplying the emerging industry with proper, up-to-date raw materials can meet difficulties at the beginning. However, both suppliers and merchants are striving to adapt flexibly to the new opportunities, take part in marketing actions, strengthen their position by investments, and appear with integration efforts of various direction and size. If the company recognises these on time and responds to them, it can achieve considerable competitive advantage from it.

4. Shifting mobility barriers: the companies competing in emerging industry have to estimate the behaviour and possibilities of new entrants into the industry in advance by assessing what barriers hinder

[45] A cluster is a formalised integration of interconnected companies, specialised suppliers, service providers, and associated institutions in a particularly field that are present in a nation or region in order to realise the common goals of the branch more effectively. There can be disagreements about the term among reseachers, especially with respect to the formalisation of the connection.

them and how, at what costs and in what time span the new participants are able to overcome them.

5.2.3.2. The competitive strategy of growth and maturity life cycles

The common characteristics of the environment:

1. Due to the slowing down of growth, the competition for gaining market share will grow increasingly fierce: The growth rate of sales slowdown and the companies won't be able to maintain their position by the market increasing means applied before any more, and its strategy will focus on attacking competitors by mobilising its internal resources. They can compete in price, quality, variety and innovation. However, they have to take into account the fact that the competitor can also take retaliatory measures.

2. The companies of the industry will sell their products more and more for experienced customers: to induce customers with extensive knowledge and experience of their own requires new strategy compared to the one applied in emerging business.

3. The area of competition often changes, and a greater emphasis is laid on costs and customer service: as competition becomes more intense, cost pressures increase, and customers' requirements also increase gradually, so the company must adapt to the change in the area of competition.

4. Increasing industry capacity and work force should be considered: businesses also have to adapt to decreasing sales growth, and thus a further capacity increase should be considered as it can result in surplus capacity.

5. The methods of production, marketing, distributions, sales and research must often be changed: it is justified by the rise of competition, technological maturity and growing customers' experience.

6. It is more difficult to create new products and new applications: cost pressures caused by competition becoming sharper make innovations more difficult, and at the same time, risks also increase considerably. Research must be done on a new basis as well.

7. International competition increases: the industry also becomes globalised, which does not only make competition sharper, but it has several other impacts as well, which won't be discussed in this chapter.

8. During the transitional period, industry profit often decreases, sometimes only temporarily: Due to the slow-down of growth and customers becoming more experienced the profile of industry usually decreases in the short term, which affects some companies more, others to a smaller extent. Whether profit will increase again depends on mobility barriers, industry structure and several other factors.

The choices of transition strategies

1. **Strategic dilemma: Comprehensive cost-leadership, differentiation and focus:** there can be several different strategies beside each other. However, companies are forced to make a choice in the maturity stage in order to survive.

2. Sophisticated cost analysis: due to sharp competition, businesses are forced to use more and more accurate and careful means in order to maximize competitive prices and achievable profit.

3. Product-range rationalisation: product structure must be reconsidered, non-profitable products resulting in weak consumer demand must be eliminated, and the ones available must be developed to have such characteristics which satisfy relevant and solvent consumers' needs.

4. Setting the right price: see point 2.

5. Technological innovation and production planning: the importance of innovation increases as the product- and service system must facilitate low cost planning and regulation.

6. Extending product range: one means of increasing purchases by consumers available can be extending the current product range, which can be more profitable than exploring and developing new markets.

7. Entering the world stage: the company can avoid competitive pressures involved in the maturity stage if it crosses its country border and enters the words stage.

8. Leaving transition: depending on the competition situation, a choice can be disinvestment, which can be a more successful strategy in an uncertain, dynamically changing environment than staying in the aggressive competition.

5.2.3.3. Competitive strategy of declining industry

"From the point of view of strategic analysis, such an industry can be regarded as declining in which sales volume decreases over a longer period in the absolute sense. According to the life cycles model, the decline stage of an industry is characterised by decreasing profit margin, curtailed product range, decreasing

research, development and advertising activities as well as proliferation of competitors. [46]

The characteristics of competition:

Demand conditions:

- **Uncertainty**: how uncertain competitors further decrease in market demand regard. If competitors expect competition to revive again, they try to maintain their positions, which can result in desperate warfare. In the opposite case, it seems to be simpler to draw all capacities out. Of course, expectations are not sure to be homogeneous; certain players can expect revival while others prefer to draw out. The rate of this determines the primary market processes.
- **The rate and mode of decline:** in the case of slow decline there is a greater uncertainty about future processes. If demand decreases at a quick rate, it is difficult to justify optimistic expectations, the process is more unambiguous. If the rate of decline fluctuates, it makes the situation more uncertain and it can even cover the declining tendency temporarily.
- **The structure of remaining demand:** The narrower demand becomes, the more important roles the remaining ones play as while they are being satisfied, even result can be realised. Exploring and satisfying the available demand gaps can yield considerable results. The end game is solvent only if the remaining customers are not price sensitive or have weak bargaining powers.

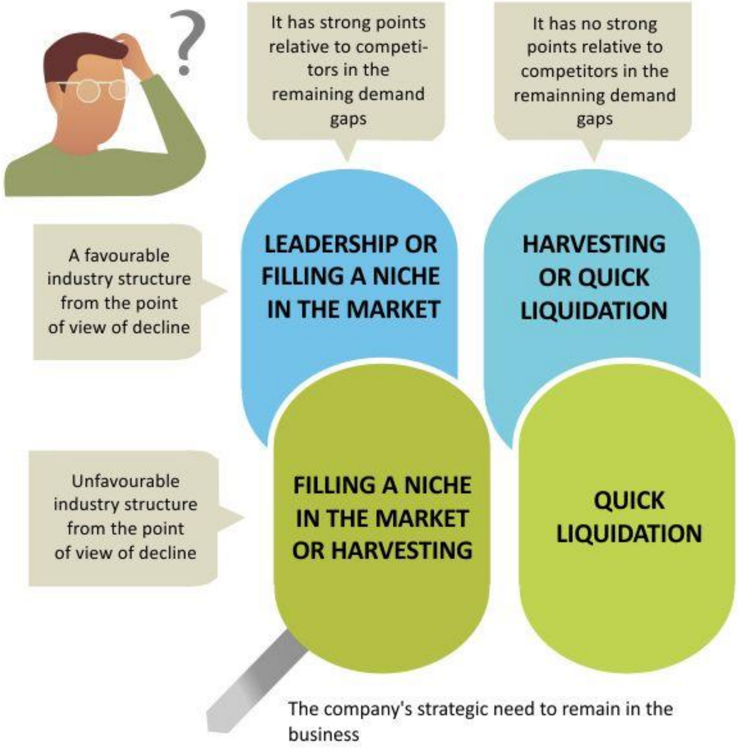
Exit from the market is a common strategy among companies of declining industries. Exit, however, is not as easy as it seems at first sight. The company seeking to exit market has to face several restricting factors. Such barriers can be as follows:

- **Permanently immobilized and specified physical resources:** If a business is mainly specialised in one division and site, these are difficult to be mobilized and selling or transforming them has barriers. It is crucial to consider how the book value of the resource is related to its liquidation value. If the former is bigger, then the resources have to be amortised at exit and thus it is a deterring factor for businesses.

[46] M. E. Porter: Versenystratégia Akadémiai Kiadó Budapest 2006 p 237

- **Permanent costs of exit**: at exit there are several unavoidable cost factors to be taken into consideration, such as settling industrial relations, providing spare parts at least until the deadline determined in law and costs of breaking long-term contracts, etc.
- Strategic barriers of exit:
  - **Interlocking**: part of the strategy of the division related to the given division group and leaving it can decrease the success of strategy.
  - **Access to money market:** Exit can decrease the trust that capital market placed in the company, and thus its borrowing capacity as well.
  - **Vertical integration**: If the company has contacts with the one or more players of the division, the difficulty of exit depends on whether the whole verticum is affected by the decline.
- **Information barrier**: If the company does not have a sufficient amount of real information about the real situation of the division, it cannot decide on appropriate, economically justified measures.
- **Management or emotional barriers:** this barrier exceeds every rational economic expectation. Exist can result in the managers' losing their job, they it as a failure, and therefore managers are trying to avoid it.
- **Governmental and social barriers**: The government tries to take measures in order to save the industry because the loss of many jobs can have unforeseeable consequences for the economy. It can interfere directly (e.g. consolidation, subsidy) or indirectly (e.g. by making the conditions for exit difficult).

Strategies in the stage of decline



24. ábra: Strategies in declining industries [47]

1. **Leadership**: the business is striving for leadership in terms of market share yet achievable.
2. **Filling a niche in the market**: acquiring some market segment and developing a strong market position.
3. **Harvesting**: regulated disinvestment besides realising yet attain-able sales.
4. **Quick divestment**: a quick liquidation realised in the earliest possible stage of decline.

[47] M. E. Porter: Versenystratégia Akadémiai Kiadó Budapest 2006 p 252

The competitive strategies described in Lesson 5 outlined the choices of a business, without aiming at completeness. There are several others methods for the classification of strategies in the economics literature, but - due to their length- they won't be discussed in this lesson.

5.3 SUMMARY, QUESTIONS

5.3.1 Summary

In this lesson we got acquainted with the concept of competitive strategy, the main classification possibilities and types of strategies, as well as we discussed the strategies that can be applied according to industrial life cycles.

Strategies were classified into four main types according to competitive position:

1. Cost leadership strategy
2. Differentiation strategy
3. Differentiation focus strategy
4. Low cost focus strategy

The latter two are called together concentration strategy.

According to the response to environment, the following types of strategy can be distinguished:

1. defenders
2. prospectors
3. analysers
4. (reactors)

In terms of competitive situation and the rate of market growth, strategies can be interpreted in four dimensions, according to whether the competitive position is strong or weak, and whether the rate of market growth is slow or quick related to this.

According to orientations, we can distinguish the following types of strategies:

1. customer-oriented

2. company-oriented
3. competitor-oriented

On the basis of the above classification, the competitive strategies that can be implemented in various industry life cycles were discussed in detail.

Furthermore, we also got acquainted with the general structural characteristics of emerging industries, the barriers of cycles and the strategies choices to be made accordingly.

We also discussed the main types of choices that can be made according to the general structural characteristics of the transition from growth to maturity.

Finally, we described the competitive factors and exit barriers characteristic of the stage of decline as well as the possible strategies.

5.3.2 Question for self-assessment

1. What does company strategy mean?
2. What can be strategic business units?
3. At what company levels is strategy creation interpreted?
4. What is competitive strategy called?
5. What does Porter's wheel of competitive strategy show?
6. What strategy types are there according to competitive situation? Characterise each type briefly.
7. What strategy types do we know according to its relation to the environment? What factors are examined when determining strategies?
8. What strategies can be implemented according to competitive situation and market growth?
9. What strategy types can be differentiated according to orientation?
10. What cycles can a industry's life be divided into?
11. What is meant by emerging industry?
12. Characterise the environment of a business operating in emerging industry in general.
13. What are the main barriers of early life cycles for an entering business?
14. What are the main strategic choices in the emerging industry?

15. What are the main structural characteristics of the industry in the stage of growth and maturity?
16. What primary strategic choices can be made in the stage of transition?
17. What can be regarded as a declining industry?
18. What are the characteristics of competition in declining industry?
19. What are the exit barriers for companies in declining industry?
20. What are the characteristic company strategies in declining industry?

5.3.3 Practice tests

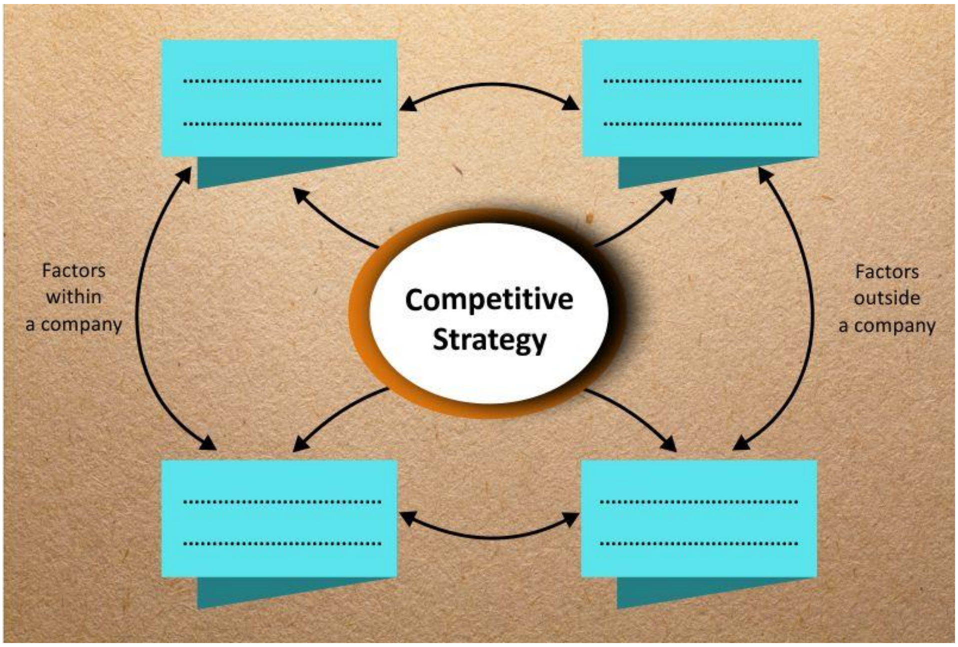
1. Choose the statements which are true (T) and the ones which are false (F).

1. The success of strategic business units can be assessed in relation with that of the other areas of the company.
2. The wheel of competitive strategy shows the key areas of environmental factors needed for company strategy.
3. In concentration strategy, the aim is to reach only a narrow consumers' group on the target market.
4. Low cost strategy means that the company appears on the market with a wide range of products with low prices at low-cost level.
5. Defenders require a stable environment while prospectors adapt well to the dynamic change of the environment.
6. Reactors adapt flexibly to the challenges of the environment.
7. In the case of strong competitive situation but slow growth, it is worthwhile for the company to concentrate on a well-circumscribed segment of the market.
8. Company-oriented strategies focus on increasing the market role and efficiency of the company to such a high level as possible.
9. In emerging industry strategic uncertainty means that at the time of introducing new technologies it is not known which one will be successful.
10. The strategy which is characteristic of the growth stage of industry life cycles can be filling market gap.

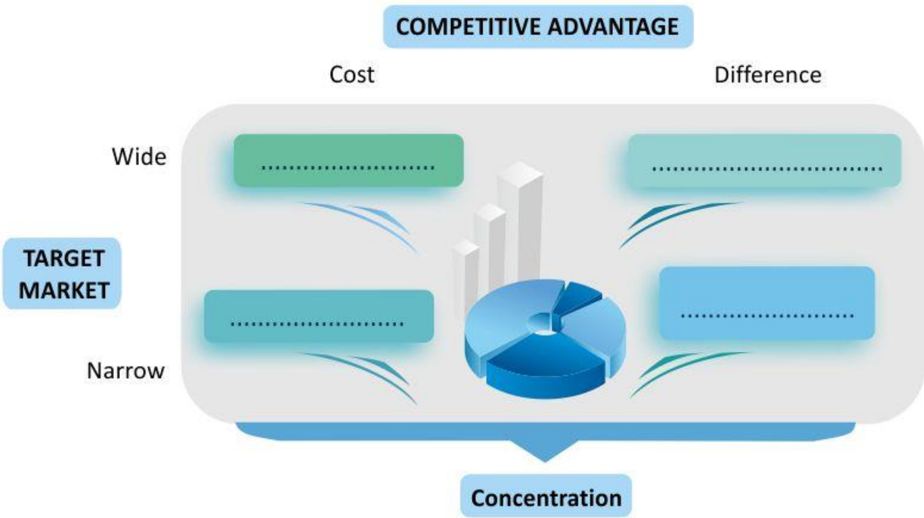
2. Match the characteristics with the appropriate strategies.

Characteristics	Strategy
(1) Low-cost strategy	a, the product is unique, therefore customers are willing to pay more for it
(2) Analysers	b, besides realizing yet achievable turnover, regulated withdrawal of capital
(3) Harvesting	c, as industrial structure has not been shaped yet, the company can attempt to shape the rules itself
(4) Filling niches of market	d, acquiring a certain kind of market segment and developing a strong position
(5) Shaping industrial structure	e, the company appears with low prices and a wide range of products on the market
(6) Differentiation strategy	f, concentrate on the function which ensures successful operation and competitive advantage for the company
(7) Company-oriented strategy	g, besides maintaining the current position, new products and markets are planned

1. Fill in the figure below with the matching strategy-types.
2. What factors influence the creation of competitive strategies according to the figure below? Fill in the missing parts.



3. Fill in the strategies of the figure below.

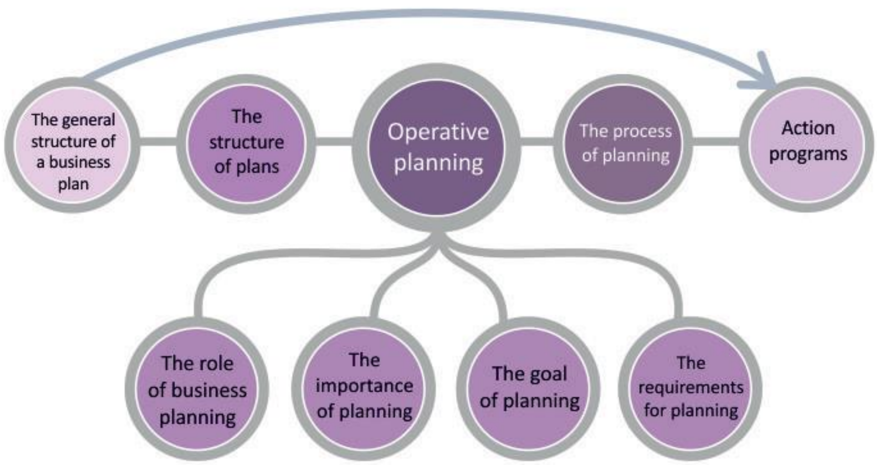


6. OPERATIVE PLANNING: THE RELATIONSHIPS OF BUSINESS PLANS AND ACTION PLANS (G. SOÓS)

5.4 OBJECTIVES AND COMPETENCES

In this lesson students will get acquainted with the basic concepts and methods of business planning. They will be able to choose the type of business plans suitable for meeting the given information needs. They will know the necessary contents and the structure of a business plan, and will be able to make suggestions for its contents for a given company.

5.5 COURSE MATERIAL



25. ábra: Concept map

5.5.1 The role of a business plan in the life of a business

In Chapter 2 we got familiar with the concept, time horizon and characteristics of planning. In terms of time horizon, strategic plans are made for a longer time, generally for 3-5 years or for even a longer time. Business plans break down the long-term goals formulated in the strategy for a given economic year.

A business plan formulates for the whole of the company the goals meant to be achieved for the period of the following 1-3 years, as well as the means needed for achieving the goals and influencing the future broken down on the different business units of a

company. Thus, based on strategy, plans such as the purchase plan, marketing plan, sales plan, financial plan or human resources plan will be made. Besides, the task of a business plan is to coordinate the above mentioned business units on a strategic basis.

In big corporates, the business plan made by the managers is short and aims perhaps mainly at strategic monitoring, while clearing the details of production programmes and implementing them are the tasks of the middle-management. Although small companies have no capacity for such selection, it is advisable for the owner-manager to write down for his own purposes the amount of the expected earnings in that given year, and to calculate whether it will be enough at least to cover the expected costs. However, later in the majority of cases, it is enough for him to distribute the relevant jobs “from memory”.

The preparation of a business plan is based on predicting future processes, which – as it can be easily seen – cannot be done with entire certainty. Why is it yet important for a business to prepare a business plan?

6.2.1.1. The importance of planning

There are several reasons why strategy creation and business planning are necessary:

1. When preparing a plan, a company must consider where it is at the present time and where it wants to get. At the same time, the company makes a thorough examination of the external and internal environment, takes influencing factors into consideration, and tries to get prepared for expected changes. By this the company **reduces the uncertainty of operation**.
2. The company is **guided** and at the same **motivated** by achieving a given goal. It can provide a basis for the coordinated operation of the whole organisation, and thus greater **efficiency** can be achieved. As general experience shows, companies having a strategy can function more efficiently.
3. The company has formulated a clear image of the aspired future whereby it is more realistic for it to achieve **a long-term survival.**
4. Preparing for expected events enhances the company’s **adaptation abilities,** and thus by following (or even avoiding) changes, the flexibility of the company increases. At the same time **meeting costumers’ needs** and **making use of competitive advantages** can also be enhanced.

6.2.1.2. The goals of planning

Apart from formulating the above goals, a business plan can be made for the following goals:

1. Presenting the activity to proprietors, creditors, preparing investment decisions and convincing new investors (banks and tender competition managing organisations, etc.).
2. New ideas, innovations, realising innovations with a great uncertainty factor and modelling expected results.
3. Paying attention to and monitoring business results and the expected development continuously.
4. A plan prepared for business partners, strategic associations.
5. Company risk managing, providing the foundations for realizing controlling activities.

6.2.1.3. Requirements for planning

A good business plan must meet the following requirements:

1. **Reality**: it must be based on real fact.
2. **Complexity**: when planning the particular components of the plan, the impact on the whole process must be taken into account, and the parts must fit into the system of the whole plan, respectively. Besides, they must follow the ideology of the strategy.
3. **Consistency**: the goals and means of the given plan must be free from contradiction.
4. **Flexibility**: the designated goals and the means needed to achieve them should adapt to the given circumstances and, if necessary, to their change.
5. Planning should help the job of the management effectively.
6. It should determine the goals so that it should be motivating for all levels of the organisation.
7. It should be appealing for investors, creditors, partners and proprietors.

6.2.1.4. The structure of plans

The structure and length of strategic and business plans depends on what purpose they are made for.

1. If the goal of the business plan is borrowing from a financial institution, credit application must comply with the form, contents and

length required by the bank. The main characteristic of such plans is that the expected return of the financial means meant to be invested and the repayment capability stand in their focus. The emphasis is laid on financial calculations, the textual description is short, it has a summarising character and is easy to understand for experts. Of the various business units of the company, only the ones involved in investment and development must be presented in detail.

2. If the business plan is prepared for external partners, e.g. professional organisations and strategic partners, more emphasis is laid on realising professional tasks, and instead of calculations a textual presentation and justification are given more attention to. The areas affected most by the partner will be emphasised in the plan.
3. If the plan is meant to serve the internal goals of the company, both the textual presentation and the calculations are emphasised. The calculations contain the methodology of deduction, the partial results and their justification as well. It tries to introduce all business units of the company.

Summarizing, a business plan:

- helps businessmen to set initial goals at the start of the business,
- estimates the expected viability of the planned, start-up business,
- examines the difference between the actual and expected situation and how it can be bridged over,
- shows what resources are expected to be necessary to achieve the goals,
- point to such areas inside and outside the company which require more attention due to their riskiness,
- improves the adaptation and reaction abilities of the business,
- points out the areas to be developed in the case of functioning businesses,
- points out the barriers of the business.

6.2.1.5. Planning according to the role of time

In terms of time span, planning can be classified into two basic types:

1. **Static planning**: the planned values are planned for one given point of time, period of time.

2. **Dynamic planning**: several periods of time are examined, plans are made along these and planning parameters also have a time dimension. Here the goal is not to achieve a definite value but to determine the optimal development direction.

6.2.1.6. The level of risk arising during planning

While planning, we use different data from different information sources, the certainty of which is of different level, and the estimations made from them also represent various risk levels.

Accordingly, the riskiness of the used facts and data can be:

3. **Certain data, circumstance**: we have a whole range of information about the circumstance, and the area can be predicted with a great certainty.
4. **Uncertain data:** we don't have a whole range of information about the circumstance, and thus prediction is uncertain.
5. **Risky data**: we have only a few uncertain data about the circumstance, and thus prediction has considerable risk.

5.5.2 The process of business planning

The business plan – as it was mentioned before – will be deduced from the strategic plan. In this case, the task is to break strategy down into the necessary areas. When founding a firm, the steps presented below are necessary for business planning. However, it must be pointed out that the contents of a business plan prepared for a different purpose (e.g. credit application, recalling risk capital or fusion) and the steps of planning are different from the ones described below in accordance with the purpose.

1. **Diagnosis**: As a first step of business planning the influencing factors of the external environment and the internal capacity of the company must be examined. Similarly to a diagnosis made by doctors, it gives a description about the present situation.
2. **Prognosis**: On the basis of the assessed external and internal factors, it must be estimated what expected impacts they can have on the future. Prediction is influenced by the reliability and riskiness of the data, the complexity and dynamism of the environment. This step is called prognosis, which, similarly to a weather forecast, tries to predict the expected process or state

from the static state of the present data, and its dynamism examined for a long period of time.

3. **The formulation of goals**: The starting point is given by the past and expected circumstances, to which the business adjusts its own goal system. It is important that the goals should be determined always in the full knowledge of the given circumstances since – as it was mentioned at the beginning of the lesson – a primary requirement is that planning should be realistic.

A business is planning to open a place of amusement in the city centre. The situation assessment must contain whether the local government concerned would approve of it, or the people living there would try to prevent it, in other words, whether this plan could be compatible with the social expectations or the legal environment.

4. **Allocating resources to the goals**: When the business determines what it wants to realise in the following period, for example, in the following economic year[48], the management must also consider how and by what means it can do it, whether it has the various resources needed, such as machinery, capacity, work force, expertise, experience and financial capital, etc. Goal by goal, it must be considered and planned what resources will be needed for each goal. If it is noticed that there is a shortage of some of the resources, it must be planned how to acquire them (e.g. investment into a new production line, employing new work force and leasing, etc.).

Developing action programmes: If the resources needed to achieve to goals are available, or it has realistic chances to acquire them, the activities and processes necessary to achieve the goals must be planned.

Action programmes are measures plans broken down from strategy and created as a part of the business plan which determine for each business unit the definite activities and procesess by which the goals set in the plan can be achieved.

Action plans – unlike the goals at the principle level formulated in strategy – prescribe definite measures for every business unit (purchase, sales, employment, marketing and finance, etc.) what kind of processes must be implemented in the given unit to achieve the goals formulated in

[48] The economic year can different in different countries. In Hungary it lasts from January 1st to December 31st, i.e. it corresponds to the calender year.

the strategy. In other words, in the business plan the system of measures and resources needed to realise plans must be developed for each business unit. These will be the action plans.

5. **Monitoring**: Following the period of a business plan, it must be examined what results were yielded by the implementation. This examination must be carried out at the end of the **plan period**, but it is more effective if the impacts of particular measures are monitored continuously, built in the process following the beginning of the implementation. The controlling system of bigger companies offers an up-to-date possibility for this. There is another reason why continuous observation is essential, if deviation from the plan is experienced, it is possible to interfere immediately, correct the measure, or if necessary even the plan. When the examination is carried out subsequently, it is not possible for the business to make corrections. Correction can be made only for the next plan period. Consequently, the aim of monitoring is to examine whether the measures taken were closed with the expected result. If deviation from this is experienced, the cause of it must be examined. If the cause can be removed, an attempt must be made to, if it cannot be removed, new measures must be taken in accordance with the circumstances recognised. An important role of monitoring is to integrate the experiences of the favourable factors and shortcomings recognised at this point into the planning process of the next year.

5.5.3 The structure of a business plan

The structure of the business plan depends on the purpose it was prepared for. Thus the structure and contents of different business plans can considerably differ from each other in the case of a given business. In the following, we will introduce the general format that can be accepted for most types of business plans, but especially to meet internal planning needs. A characteristic form is the general planning to found a firm and operate it.

You can read about the business plan of the company Toyota on the website of The Wall Street Journal: http://online.wsj.com/news/articles/SB10001424052748704132204576189824246558988

5.5.4 The general structure and organisation of a business plan

The structure of the plan

I. Introduction, general data
II. Executive summary
III. Company description
IV. Environment description, features of the industry
V. Marketing plan:
 V.1. Description and planning of products, services
 V.2. Price policy
 V.3. Sales plans
 V.4. Promotion plan
VI. Operational plan
VII. Organisational or human resources plan
VIII. Risk assessment and plan
IX. Financial, financing plan
X. Appendices

The characteristic contents of the particular chapters

I. Introduction

This chapter contains the general data, designations and the main features of the business. These data can partially be found in the certificate of incorporation and partly in official registration of the business. Such are for example:

- the name of the business (complete or short name[49])
- contact details of the business (address, telephone number and email address, etc.)
- other data for identification of the business (bank account number, tax identification number, statistical number code, etc.)
- the proprietors of the company and their contact details as well as the person(s) entitled to represent the company and his/her/their contact details
- the main operational field of the business (according to TEÁOR, SZJ[50])

[49] The full name is for example Kisvakond Trade and Sercvice Company Limited,the short name is Kisvakond Kft.

- the foundation capital of the business
- the date of the preparation and approval of the business plan
- warnings to treat the data confidentially

II. Executive summary

The goal of the summary is to give an overview of the most important factors revealed in connection with the business, the goals to be achieved, the necessary development needs and the measures to be taken to achieve goals. The summary must be compiled in such a way that it should give an insight into the main statements of the plan for those who don't want to or won't be able to read the detailed plan as well.

In the executive summary it is worth touching upon the followings:

- the aim of preparing the business plan,
- the goals of the company, the main factors and expectations that provide a basis for the goals,
- the focus points of the industry and market situation,
- financing situation (by means of some main indicators), demands,
- summarizing the most important conclusions.

III. Company description

In this chapter a detailed textual description of the company must be given. The main areas of this chapter are:

- the main features of the operation of the company until now (activities, departments, management, general financial situation, market successes and the previous principles of operation, etc.),
- the targeted market, results of market segmentation and the main characteristics of the targeted market segment.

IV. Environment description, industry characteristics

- factors affecting the macro-environment,
- industry prospects (the situation of the industry, innovations, possibilities of growth and dynamicity, etc.),

[50] The so called two nomenclatures, i.e. standardized classification system can be found in its full-length on the web site of the Central Statistics Office Hungary (KSH) (www.ksh.hu)

- competitive situation (market structure, market share, expected entrants, suppliers, bargaining powers of customers and threats, etc.),
- the level of cooperation, possibilities within the industry,
- governmental plans, measures related to the industry,
- the most important impact factors of the operational environment.

V. Marketing plan

In accordance with the 4Ps[51] known from marketing theory, the marketing plan contains the following examined areas:

V.1. Description and planning of products and services

While planning, we must examine the success of the available products and the change of consumers' needs related to them. The subject 'marketing' describes the methods by which a business can decide which products are the most successful, which one has to be laid emphasis on, and which products should be probably developed or recalled from market. A product policy decision can also be made if the business develops a new product. An important decision of product policy is also to develop a product range. The aim is to meet consumers' needs at the best possible level.

VI.2. Price policy

Price policy is the series of decisions in which it is determined at what price the products to be sold should be put on the market. It is calculated partly by means of the costs needed to produce them, and partly the profit rate meant to be achieved. For this, the role of the business in the competition, and the primary principles of strategy to be followed it must be assessed.

In addition to the market prices, the possibilities of price differentiations must be determined (seasonal prices, discounts, periodical reductions of price, etc.)

VI. 3. Sales plan

[51] Depending on the company's field of operational, we can also meet 5Ps instead of 4Ps and primarily in the case of companies involved in offering services, we can also meet 7Ps and 8Ps. You will get more detailed information about it in the course material of marketing.

As a starting point of the sales plan, it must be planned what sales quota can be expected from particular products. Apart from this, the distribution channels that can be used (the different business types of wholesalers and retailers), and the different methods of sales (direct selling, personal selling, selling through intermediaries, automated trading, etc.) must be determined.

VI. 4. Promotion plan

In the promotion plan, it must be determined what marketing tools and what marketing mix the business will use during the planning period. On the basis of the goals formulated in the strategy, advertising, Public Relations, sales Promotion and Direct marketing and other means[52] must be coordinated.

VI. Operational plan

The operational plan details the company processes and the system of processes. The character of the operational plan depends on the type of business. Producing companies prepare a production plan, and service companies prepare a service plan while trade companies make typically a sales plan.

When preparing a production and service plan, we must describe the current production volume, the applied technologies and the capacity, equipment and work force needed for them. We must plan the changes needed to achieve the expected goals in the future as well as their costs.

A sales plan contains the methods and conditions of purchasing goods, the current and expected speed of stocks turns, packaging, methods of handling orders, the necessary equipment and human resources, and the arising costs due to these, respectively.

VII. Organisational plan

An organisational plan describes the proprietorial structure, the management, the organisational structure and the main principles and goals of workforce management of the company in order to implement the goals. On the basis of the goals it must be determined how to develop the available human resources capacity. It is possible to take on new employees, to reallocate group workforce within the company, to further

[52] You can read more about these means in the course material about Marketing.

develop the knowledge and skills of current employees and to redeploy duties- and responsibilities.

VIII. Risk assessment

On the basis of an environment analysis and internal examinations, it must be assessed in each planning field what risks can arise, what is the probability that they will occur, and what measures can be taken to terminate, to eliminate or avoid them.

It is crucial that the risk analysis should done thoroughly, covering all areas. This is how it can ensure that the company will be able to adapt to risks in a flexible way, which can be planned.

IX. Financial and funding plan

A financial plan describes the current financial situation of the company (incomes, expenses, outgoings, costs, liquidity, profitability and rate of outside capital, etc.), the result meant to be achieved and the stock of financial means needed to ensure it and its movement.

The financial plan generally contains a planned balance sheet, a planned income statement, an income plan, a liquidity plan and a planned cash-flow. Besides, it details how the indicators relevant for the operation of the company change (e.g. liquidity and profitability, etc.), evaluates them, and on their basis, it determines the goals to be followed in the finance area and the necessary measures (e.g. borrowing, issuing bonds and rebuying securities).

If the business plan was prepared in order to borrow, this field of planning is placed most emphasis on. In this case, a separate plan must be prepared for the realisation of the investment as well as for the repayment of the received source. Furthermore a financial plan for the return of the investment must also be prepared.

X. Appendices

In the appendices, all documents, background studies and supplementary notes can be attached to the business plan, which provide the basis for the plan or support the ideas, goals formulated and the calculations made in the plan. Examples for these are the result of market research, bids, consumers' and sellers' feedbacks, preliminary agreements, declarations of intent, technical descriptions, publications, and a patent inventory, etc.

In fact, business plans and action plans cannot only be prepared by the businesses of the for-profit[53] sphere, this panning method appears in the non-profit sphere as well. Naturally, in the case of non-profit oriented businesses, the structure of the plan, and the ratios of particular chapters vary, the emphasis is laid on the activity and financing is aimed at ensuring the financial background of the activity.

5.6 SUMMARY, QUESTIONS

5.6.1 Summary

In this lesson the fundamentals of business planning were described. Businesses prepare a business plan for a short period of time, for 3-4 years by breaking it down from strategy. It can be prepared with differents aims. The most important ones are perhaps prepared for the internal goals of a company, to determine the goals and the measures needed to be taken to achieve these goals, for financial institutions due to borrowing, or to inform proprietors.

Planning – although the future is always uncertain – is important for the company to be prepared for expected events, given the environment and the internal capacity of the company, to assess risks and outline solutions if these should occur. Planning facilitates the adaptation skills of the company, and its flexible adaptation to the challenges of the environment. Furthermore, it guides the activities of the company, motivates the ones concerned and provides a basis for assessing efficiency.

A good business plan meets the requirements of reality, complexity, consistency and flexibility, helps the job of the management, encourages and appeals to investors.

A business plan can be made statically (for a given point of time) or dynamically (covering a given period of time). In terms of the data used, the risk of planning can be different as well.

During planning, first a diagnosis is made, and then the prognosis is determined. Next the goals are formulated, and the resources are aligned with the goals. On the basis of these, action programmes, the measures plan can be made, and the results of monitoring must be integrated into the next planning process.

The structure of the business plan depends on what and who it is aimed at.

In general, it contains the following parts:

I. Introduction, general data

[53] profit-oriented

II. Executive summary
III. Business description
IV. Environment description, characteristics of the industry
V. Marketing plan:
  V.1. Description and planning of products, services
  V.2. Price policy
  V.3. Sales plan
  V.4. Promotion plan
VI. Functional and operational plan
VII. Organisational and human resources plan
VIII. Risk assessment and plan
IX. Financial, financing plan
X. Appendices

If the business plan is made by non-profit organisations and institutions, its structure and emphasised chapters can be different from what was described above but these general formats can be followed in their basic principles.

5.6.2 Questions for self-assessment

1. What is a business plan?
2. What time horizon is the business plan prepared at?
3. How are strategy, the business plan and the action programme related to each other?
4. Why is it important to prepare a business plan?
5. What purpose is a business plan made for?
6. What are the primary requirements of planning?
7. What does the structure of a business plan depend on?
8. What can planning be like in terms of the role of time?
9. What levels of risks can arise during planning?
10. What are the steps of the process of business planning?
11. What are action programmes and how are they related to the process of planning?
12. Describe the general structure of a business plan. What do its particular chapters contain in general?
13. Can, for example, a governmental institution prepare a business plan? In what way is it different from the outlined general format?
14. How is the business plan of a production, service or trading company different?

5.6.3 Practice tests

1. Choose the statements which are true (T) and the ones which are false.

1. Strategy is broken down from the business plan.
2. A business plan is typically made for a period of 1-3 years.
3. The risk of operation is decreased by planning.
4. The adaptation ability and flexibility of the business decrease by planning as they have to comply with the goals of planning.
5. A company makes a business plan usually for its internal goals, creditors or competitors.
6. The business plan provides a basis for risk handling and the controlling activity.
7. The requirement of complexity means that the goals and means of the given plan should be contradiction- free.
8. If the aim of preparing a business plan is borrowing from a financial institution, financial calculations are laid more emphasis on during planning.
9. The business plan highlights areas inside and outside the company which require more attention due to their riskiness.
10. By uncertain data is meant that there are only some uncertain data available for the circumstance, and thus prediction yields considerable risks.

2. What is the correct order of the panning process? Put the right number in front of the particular steps of planning?

…………. Monitoring
…………. Prognosis
…………. Action programmes
…………. Diagnosis
…………. Assessment of resources
…………. Formulation of goals

3. Match the chapters of the plan with their contents.

Chapter of plan	Contents of chapter
III. Company description	a) It should give a picture about the

	most important statements of the plan to those as well who do not want or are not able to read the detailed plan.
X. Appendices	b) Plans the marketing-mix to be applied.
VIII. Risk assessment and -plan	c) Contains information about the industry prospects and competitive situation.
IV. Environment description and industry characteristics	d) Preliminary agreements made and declarations of intent can get into this chapter.
V.1. Description and planning of products, services	e) The data of this chapter can partly be found in the certificate of incorporation.
I. Introduction, general data	f) Describes that redeploying of work force or taking on new employees are necessary.
V.2. Price policy	g) Describes that on the basis of expenses and planned profit at what price the products must be sold.
V.3. Sales plan	h) Often contains cash-flow.
VI. Functional and operational plan	i) Describes what distribution channels are targeted by the company.
VII. Organisational or human resources plan	j) Sales plan is a characteristic of trade companies.
IX. Financial, financing plan	k) The characteristics of business operation (activities, departments, management, etc.) until now.
II. Executive summary	l) Describes which products must be developed or recalled from the market.
V.4. Promotion plan	m) The reliability, the accuracy of the data, and the probability of the occurrence of the events must be examined for each company business unit.

4. Which are is more emphasized in the particular business plans? Match the plan prepared with a particular goal and the parts of planning which are emphasized.

Plan	Emphasized area
(1) the business plan for investors	a) the processes of the business, the success, efficiency and profitability of its operation
(2) the business plan for proprietors	b) both textual description and calculations
(3) the business plan for external part-	c) tasks and resources as well as their

ners	financing
(4) the business plan for the goals of internal use	d) financing and return
(5) the business plan of a non-profit firm	e) realising professional tasks

5. Of the following characteristics, choose the requirements that a good business plan should necessarily comply with. (There are several possible good answers.)

1. It determines the job of management accurately.
2. It should be encouraging for the ones concerned.
3. It should give an ideal picture of the business.
4. It should be realistic.
5. It should be numerical.
6. It should be flexible.
7. It should be contradiction- free.
8. It should make the job of the management easier.
9. It should show how the company management should manage the profit.
10. It should guide the relationship of the organisation and its partners.

6. According to comprehensive character, fullness of details, put the following levels of planning in a descending order.

Action programmes
Strategy
Business plan

7. Match the type of risk and its characteristics.

Risk	The characteristic of risk
(1) Risky data	a) we have a full range of information about the circumstance
(2) Certain data	b) there isn't a full range of information about the circumstance available

(3) Uncertain data	c) there are only some uncertain data available

6. MANAGEMENT OF OPERATIONS AND SERVICE SYSTEMS (A. NOVOTNY)

6.1 OBJECTIVES AND COMPETENCES

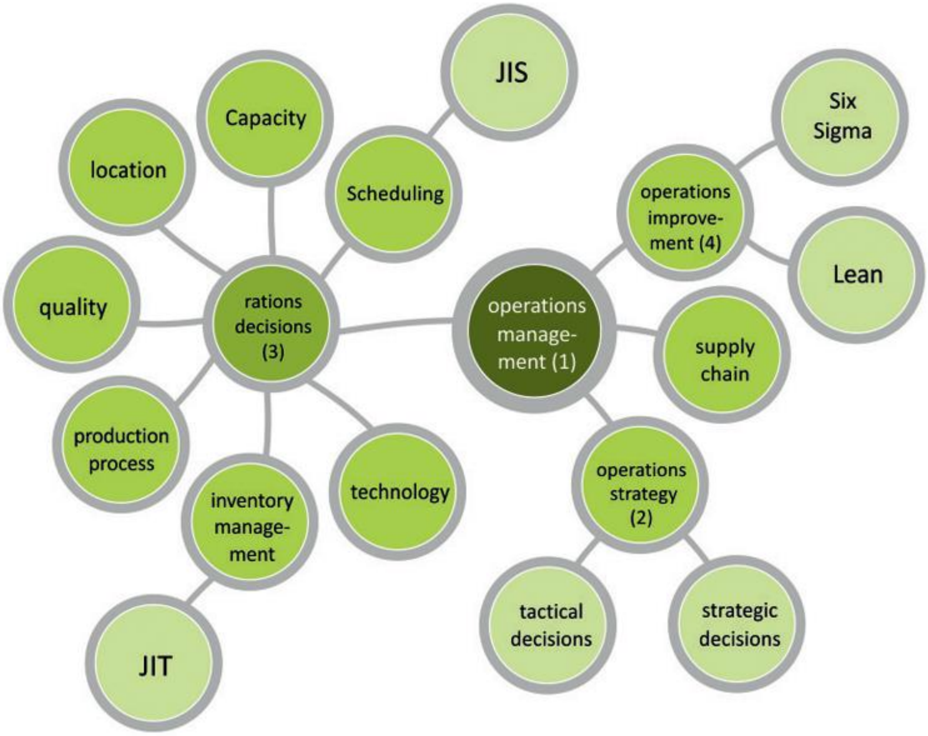
In this lesson the primary issues of managing operations and service systems (short: operations management) will be discussed, illustrated by realistic, life-like examples. Every organisation consists of processes, whether it is one which is produces products, offers services, profit-oriented, non-profit, small or big. The processes run parallel with each other, complementing each other. The task of operations managers is to plan and control the processes related to operations and service. After completing the lesson, students will be able to:

- identify the operations-service process in any organisation,
- describe the operations processes of the organisation as well as characterise them on the basis of the character, quality, capacity, scheduling, technology and stock piling and
- understand the importance of management and the tasks of operations managers.

Every organisation has to deal with operations since every organisation produces something, a particular combination of products and services (nowadays it doesn't matter whether we talk about products or services). Many organisations, mainly the small ones don't use the words *operations management*, because operating or offering services are done by such specialists who also have other tasks (e.g. marketing or company managements). The decisions made by the operations management play an important role in how a company produces a product, and thus it has a crucial impact on incomes and expenses as well as on the profit level.

The competence to be acquired in this lesson is **the process-view of operations** because every product or service will be produced during particular work-processes. Processes can be repetitive or intermittent depending on what different kinds of products and in what quantity are manufactured by the company. Car factories work mostly according to repetitive while a sculptor works mostly according to intermittent, periodical processes.

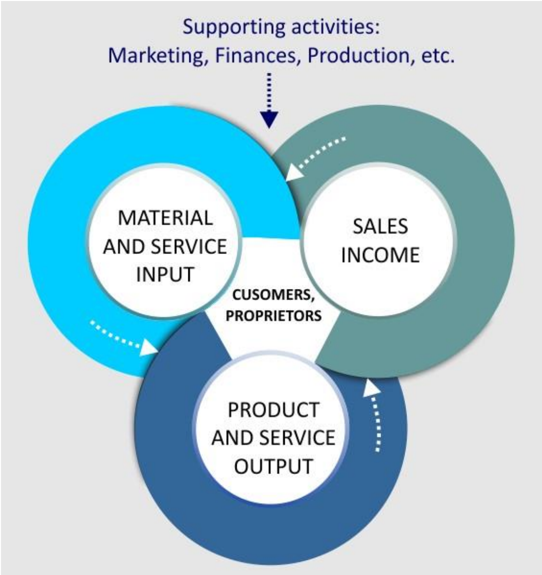
6.2 COURSE MATERIAL



26. ábra: Concept map

6.2.1 The interpretation of operations management

Production (turning raw materials and services into output) is one of the strategic functions of an organisation which has a considerable impact on how to use resources and how to achieve company goals in the long run. In addition to **marketing** (helping sales) and **finances** (acquiring resources), production is the third most important organisational function.



27. ábra: The strategic processes and functions of an organisation

Operations management can be interpreted for services as well. For example, in the case of a restaurant it covers such decisions as location, furnishing, quality and capacity (the maximum number of customers); choosing and training staff (cooks, auxiliary employees and waitors, etc.), the method, process and time of preparing dishes, organising servicing up dishes, furthermore purchasing ingredients, cookers, refrigerators and other kitchen utensils and choosing related suppliers. If all these are done well by the company, both customers will be satisfied with the quality of dishes and servicing, and the restaurant can earn profit.

To put it simply, *operations management* means turning inputs (work, infrastructure and raw materials, etc.) necessary for production (and offering services) into a product or service for both the external and internal customers of a company.

28. ábra: The process of operations management

The secret of successful operations management is turning inputs into output meeting customers' needs, moreover in a more effective way than competitors do. The engineers of 3M designed such an adhesive tape which functions more effectively than other adhesive tapes on the market. In addition to understanding customers' needs perfectly (thorough marketing work), the secret of 3M lies in a developed manufacturing process (thorough engineer work):

”The Scotch® Magic tape is invisible when applied! It is magically many-sided: it can be seen on photocopies, fax or paper, can be written on with pen or pencil or marker, ink doesn't get blurred on it, resists drying out and yellowing does not turn yellow, pulls off the roll smoothly and cuts easily. It is ideal for permanent paper mending. It is available in cutting blocks of various forms and colours. The most popular varieties of the cutting blocks are the ones with a snail and donut base.” – as it can be read on the Hungarian website of M3. This environmentally-friendly tape advertises the social responsibility of M3:” Scotch® MagicTM has been manufactured from natural fibres by a solvent free process for many years. The life-cycles management view applied during its manufacturing is meant to decrease the impact of the product on the environment. Now you can also make a step for the environment: choose the environmentally-friendly scotch tape of M3, which is made from 100% recycled paper.”[54]

The whole organisation and its every unit **plan and operate processes.** Operations management covers several planning, managing and controlling processes which are aimed at manufacturing the product, and delivering it to the customer. The sum total of the operations processes is called *supply chain*. The supply chain lasts from extracting the raw material to delivering the finished product it to the end-users, and this it also involves the purchasing processes prior to manufacturing and of-

[54] 3M Magyarország, Scotch ragasztószalagok, http://solutions.3mmagyar.hu/wps/portal/3M/hu_HU/EU-Office/Home/ProdInfo/ScotchTape/

fering services. Through the supply-change management, companies purchase the necessary inputs (raw materials, spare parts, machines), turn them into finished products, and then they deliver the products to their final destination.

6.2.2 Strategy and tactics in the operations

In practice, managers make **strategic and tactical decisions**. While strategic decisions determine the major directions of the company or a company function (production, marketing, finances, etc.), tactical decisions are short term ones and more meticulous, and facilitate the strategy becoming an action, and its implementation.

As was described earlier, organisations create a strategy in order to achieve their goals.

The aspects of corporate strategy related to operations is decribed by the operations strategy.

The strategy of the whole organisation provides a frame system for planning the other activities of the company, and in this way it determines the scope of action of the other areas, and thus that of the operation as well.

Low-cost airlines offer customers reasonable services at a reasonable price (a strategy reducing organisational strategy). Therefore, besides a safe flight, they also have to plan carefully such aspects of operations and offering services as the number of staff and the costs of their training, the weight of luggage, the quality and quantity of the food served, how well flights are utilized, and the process of buying tickets. If the airline operates only one type of planes, it simplifies the time and costs of maintenance (they have to keep a stock of fewer spare parts and mechanics can find the problem more quickly, too). Nowadays there are only two pilots needed for most planes (in contrast to previous machines with three pilots), which can considerably reduce labour costs.

The decisions related to operations (e.g. placing production capacity, installing production machinery and equipment, choosing the type of production technology and organising work) are mainly **strategic decisions** since they occupy company resources in the long run and determine profitability. Moreover, they also involve considerable expenses.

The management of a college or university have to determine how students will have access to gaining knowledge. Online on the internet, from books at home, in the library or in the lessons? Where *should the building of schools be, what kind of classrooms and study rooms are necessary? What teachers and other staff should be employed? How should they purchase the necessary equipment of information technology and the equipment for the offices and classrooms? How many students should be in one group, how many lessons should they have a day, a week and a term? How should students be kept a record of and evaluated? How should they ensure supplementary services (e.g. accommodation, meals, entertainment and sport, etc.)?*

- *An important strategic question is for most companies, governmental and civil organisations to what extent it places its activity on the internet. Nowadays ING bank operates almost exclusively online, on a computer or mobile phone. The bank doesn't rent offices for its customers but for its own employees now. This change of strategy resulted in considerable cost savings, and thus ING is able to appear with more competitive offers (better rates of interest) on the market. Only banks that have been on the market for a long time and have a reliable image are able to make such a drastic change as people still somehow distrust the financial services providers that operate exclusively online. Smart phones start to become the main means of online banking, a good example for this is the Netherlands, where customers check their bank balance five times a day via their phone. You can read more about the decisions of ING bank here:*

- *http://www.ing.com/Newsroom/All-news/NW/Banking-Group-ING-goes-digital.htm*

Tactical decisions have a short or middle term impact on the operation of a company, and mean smaller commitment with regard to company resources. Such decisions are, for example, organising work (e.g. organising shifts) and changing quality management processes or stockpiling systems.

- *In the case of an airline, such a tactical decision can be how many hours the staff of a machine work a day, a week and a year. Life can be saved by such small decisions on how the airline can ensure that the staff has a rest, e.g. what kind of a hotel they are put up at prior to the flight back. The basic rules and regulations are created by the state (obligatory minimum rest), from which airlines can deviate from in the positive direction. It was in 2014 when the length of obligatory minimum rest for pilots changed in the USA.:*

http://www.dailybreeze.com/general-news/20140103/airlines-prepare-for-new-rules-covering-pilot-rest

6.2.3 Operations related decisions

The decisions related to operations can primarily be made at two levels: at the strategic and tactical level. On the basis of which aspect of operations and service is affected by these decisions, we can distinguish operations decisions related to manufacturing processes, quality, quantity (capacity), scheduling, technology and stockpiling.

Manufacturing processes

There are primarily two kinds of operations processes: **intermittent** and **repetitive**. The **intermittent process** assigns the tasks similar to each other to different business units of a company.

For example, a GP refers the patients according to their problems to different departments. Doctors and other employees are distributed by the hospital according to the type of diseases and the ways of treating diseases. Departments for out-patients include departments for EEG diagnostics, psychiatrics, physico-therapy, labour-hygiene, radiology and lung screening while departments for in-patients include department for internal diseases, vein surgery, neurology, or urology. Patients go intermittently (irregularly) to one or other department depending on their problem.

Factories operate by means of intermittent processes when they manufacture various kinds of products, or when they have to adapt to unique expectations of customers.

For example, a furniture-manufacturing entrepreneur running a small business generally makes different kinds of products in different kinds of quality and for various customers. One particular piece of furniture appears only intermittently in his calendar. In contrast, a middle-sized or big furniture factory is specialised in serially-produced furniture and carries out repetitive processes with great efficiency and expensive manufacturing equipment.

Repetitive processes refer to very similar or entirely the same activities and manufacturing such products. A good example for repetitive processes is an oil well pumping oil continuously, or a production-line by which several different products can be produced from vehicles to hamburgers. In the case of services, treating customers like objects on a conveyer belt is quite common (e.g. a car-wash or self-service restaurants). In these cases the product or the customer goes through the same steps, during which standardized products are made and the customers get standardized services. As every single step is accurately planned, the efficiency of repetitive processes can be quite high. Although automation of manufacturing processes is costly, the costs are refunded quickly as a great number of products go through the process, and thus the investment cost per product is relatively low.

- *Here you can read about the different steps of the manufacturing process of Haribo jellies: https://www.haribo.com/enWW/consumer-information/jellies/manufacturing-process.html*
- *You can see the assembly of the vehicle Mercedes Benz-C-class on a conveyor-belt in the YouTube-video below: http://www.youtube.com/watch?v=1mESdS7XxIg*

The main difference between intermittent and repetitive manufacturing processes lies in the multiplicity of products and the volume of the manufactured products. Intermittent processes are flexible but less efficient: there is a long waiting time and stockpiling is uncertain. Repetitive processes are suitable for reducing costs, waiting time and stocks but they are less suitable for satisfying diverse customer' needs.

Cellular manufacturing tries to combine the advantages of intermittent and repetitive processes. Cells refer to independent work groups or work stations which can be combined in a different order during manufacturing, and thus we can get as many manufacturing processes as we want (or as many products we have). Every cell is responsible for one well-defined work process.

Quality

Quality refers to all the characteristics of a product or service that influence its ability to satisfy customers' needs. In fact, good quality is what the customers regards to be good. The two primary dimensions of quality are performance and conformance. A Mercedes is quicker, more comfortable and safer than a Suzuki, but a Suzuki is of good quality it it performs in a reliable way what the factory promises if it meets the customer's need.

If asked whether they support good quality, most managers would probably answer that they do. The question is really what they are willing to do, how much they are willing to spend on factors improving quality, for example, on choosing carefully the suppliers, machinery, production/service technologies or human resources. How much are they willing to spend on getting to know consumers' behaviour as well as possible? Do they control their suppliers' performance?

- *McDonald's treats as a main question the quality and reliability of the products sold by it, pays attention to every step of the supply-chain "from farms to restaurants". The restaurants use only 100% real (additive-free) beef-and chicken worldwide. Otherwise, chicken is prepared according to the rules of the Islam (halal). The rolls are made exclusively from high-quality wheat. The vegetables and dairy products are purchased from local or regional farmers to ensure that they are fresh. To assure quality, each manufacturing process is standardized, i.e. it is carried out in each restaurant according to the principles and methods determined in the centre of McDonald's. French fries are also taken over in excellent quality, only oil is used for frying, and exclusively salt is added to it. Foods are treated from the zero-point to the kitchen of the restaurant complying with the HACCP regulations. You can read more about the principles of the firm's quality assurance below:* http://www.mcdonalds.com.pk/page/quality-assurance

- The industrial revolution started in Europe, and later it appeared on the American continent as well. Taylor's work organisation, in which planning and execution were separated, and in which productivity was put into the foreground, had a negative impact on quality. To preserve quality, companies made quality control an independent function on a par with production. The problem with it was that quality was regarded by employees as the private business of specialists dealing with quality control, and furthermore, that the related issues of quality also became detached from the top management by it.

In Czeglédi's view (2011) by the end of the 1980s such management philosophies and methods were already formulated which aimed at not only assuring (and maintain) quality, but developing it continuously as well. A TQM, (Total Quality Management) is "a management concept of the organisation centred on quality, based on the participation of all its members and aiming at achieving long term success through consumers' satisfaction, and the benefits of all its members and society." (MSZ EN ISO: 1996). Of the principles of TQM the following five can be considered to be the most important ones (Bálint 2009): focus on the external and internal customers/users, continuous improvement of processes, participation of all employees, participation in learning together with the other organisations, i.e. becoming a learners' organisation and management.

Capacity

In operations capacity, the main question is how many products and services must be manufactured in a given time period. Big investments increasing the quantity of production influence the finances and resources of the company in the long run. Such strategic decision can be to create a new manufacturing capacity or service unit.

As for capacity, there are smaller, short term tactical decisions as well, for example, what number of staff is required in a supermarket or hypermarket to serve customers on a given day or time of day so that shoppings (how many cask desks should be open to prevent long queues but with no cashiers having a loss, either) should counterbalance wages. How many employees should deal with guests at a hotel at a time so that there shouldn't be a stoppage in the services (check-in, room-service, restaurant services, wellness area and cleaning personnel, etc.) and the hotel should produce the wages as well at the same time.

The extension of production depends on the increase of demand. Companies extend their capacities mainly when they meet over-demand on the market, and consider over-demand to be a long term on, such as Mercedes in China.

- *The Mercedes factory in Beijing, which is a joint property of Daimler AG and Beijing Automotive Group Co. doubles its production capacity to be able to keep up with increasing demand. In 2015 200 thousand Mercedes vehicles (C- and E-class sedans, as well as GLK sport-utility vehicles) will be manufactured at their Beijing plant in China. See: http://www.bloomberg.com/news/2014-03-28/mercedes-to-double-beijing-factory-capacity-as-sales-soar.html*

Scheduling

Scheduling refers to ensuring the proper combination of the work force, machines and resources needed for the production to make sure that the products and services get to the customers in proper time.

- *In hospitals aligning and scheduling operations requires thorough preparation when both the number and condition of patients and the availability of doctors, nurses and the staff of the operating theatres must be taken into consideration. Anaesthetists must prepare the patient, and the staff must prepare the operating theatre on time. In addition the operating theatre, the equipment, the necessary medical auxiliary devices and medicines must also be available.*

At the BMW plant in Munich the particular manufacturing stages are carefully scheduled as regarding the inside of a car there are at least 20 thousand varieties of manufacturing. Therefore, the seats, the doors or the cockpits are assembled in advance before they are fitted in with the body. You can read more about the production at the BMW plant here: http://www.bmw-plant-munich.com/lowband/com/en/index.html

At the BMW plant the principle of just-in-sequence (short JIS) is applied.

In JIS the spare parts arrive at the production line just when they are needed, when they are mounted in . The conditions for developing JIS supply systems fully conform to the principles of lean philosophy since the primary goal of both cases is to reveal losses and their causes, to identify the unnecessery elemets present in the system and to make them useful or remove them from the system.

In production the aim of scheduling is to minimalize the time and costs of operations by informing employees about who, when and what machinery must work. The up-to-date means of operations scheduling (by computers and visualization) exceed considerably the old methods. For example, an airline can optimize the number of boarding gates at the airport, and thus their costs as well on the basis of the data (e.g. departures and the number of passengers) fed in.

Companies can plan scheduling both forward and backward. During forward planning they can plan the time of delivering finished products considering the arrival of raw materials. During backward planning they can calculate from the obligatory time of the availability of the goods backward by what time the resources for the operations must be purchased, and according to what scheduling the product must be produced.

Technology

In simple terms, technology refers to applying scientific knowledge for operations and service.

The most important part of technology is **know-how**, i.e. the description of knowledge that usually gives a new or up-to-date solution to some technical problem. Know-how represents considerable financial value, and it can be sold and bought as intellectual product.

Technology is the heart and soul of operations and service. Soft wares, management information systems and manufacturing machinery increase the speed of operations and service, and reduce unit costs.

A drawback of technology is the high fixed cost, i.e. the cost of purchasing and installation, which is a severe risk for a company. Developed technology generally requires considerable investment, and therefore it's necessary to be cautious even if estimations about returns are optimistic.

From an economic point of view, primarily two types of technology can be distinguished: **capital-intensive** and **labour-intensive** methods of production. In the case of the former, machinery has the main role in production while in the case of the latter labour. The decision of which technology to choose depends on the quatitity of labour and capital relative to each other and its price in the given country as well as the character of the product. According to the Heckscher-Ohlin theory, the capital- and knowledge intensive products are manufactured by capital-abundant countries with comparative advantage (e.g. Germany, the USA and Japan) while in the manufaturing of the labour-intensive goods the relatively labour-abundant countries (e.g. China and India) have comparative advantage. However, it should be noted that the Heckscher-Ohlin theory has not been proven for the majority of products sold in international trade (see e.g. Leontief-paradox).

The Hungarian plant of Audi AG (Audi Hungaria Motor Kft.) is the biggest car engine plant in the world. The plant was established in Hungary in 1993 and in 2014 it started the serial production of the third generation of Audi TT Coupe. After producing 42.851vehicles in 2013, in 2014 the plant is expected to produce 120 thousand vehicles with regards to all the models manufactured in Hungary. The company has invested 6,75 billion Euros since it opened its plant in Hungary, and there are no plans for a slow-down.[55]

Stockpiling

The aim of stockpiling is to preserve the goods, as well as to balance materials flow according to need. Planning the warehouse size and the stock level is a crucial aspect of operations. Determining the warehouse storage capacity is based on the size of stock necessary for transacting sales. The size of warehouses is determined by the characteristics

[55] Harmadik generáció: indul Győrben a sorozatgyártás, mno.hu, 2014, július 24., http://mno.hu/gazdasag/harmadik-generacio-indul-gyorben-a-sorozatgyartas-1238839

of the goods to be stored (what, how much, for how long, where and how to store).

During the operations processes the movements of goods can be stopped, and during the halt a certain amount of products can appear, which is called stock. It is necessary to have a certain stock level in order ensure the continuous internal movement of the materials and semi-finished products, etc.

The most important question of stockpiling is how much stock to keep. Both too much and too little stock can hide danger. **Too high stockpiles** can lead to thefts, obsolescence and excessive immobilization of financial resources besides high costs, due to which there are few financial resources will be left for other tasks.

Too low stockpiles result in keeping consumers waiting, their dissatisfaction and falls in incomes. The size of stock is influenced by both economic and physical factors. The principle of stockpiling is that the greater the size of the goods, the shorter the set-up time of the goods through the storage process should be. Large-sized goods requiring special handling require bigger and special storage capacity, which increases storage costs.

The main reasons for stockpiling can be summarised as follows below (Grasselli, n.d.):

- ensuring undisturbed operations processes;
- ability to respond quickly to the changing customers'needs;
- changes in the operations processes (e.g. several different products are manufactured on the same line alternatively but in scheduling not fixed before.);
- prior-posterior storage of seasonal goods.

Just-In-Time (short **JIT**) is a manufaturing organisation and inventory management strategy of Japanese origin, which improves the company's operations efficiency by reducing considerably the factory's stock in process and the related cost. The process relies on a system of signals easy to use, which are called kanban ("tickets"). The work units involved in the manufaturing process chain express by these signals their need for the previous link in the chain, and their performance for the next one. The kanban system can be used on such production lines where the production volume falls between the lower limit of the medium serial production and the mass production. This manufaturing method results in short set-up time and little stock, which is the most important cost component in manufacturing today.[56]

Location

It is influenced by several factors where a company's headquarters and manufacturing facilities are located. To what extent location influences the success of an organisation depends on several factors.

- **Closeness to suppliers**: companies that regularly buy a large quantity of raw materials are located close to raw material sources. A fish-paste factory will be opened near a fish hatchery or a port, a milk factory near farms, a steel factory near a mine.
- **Closeness to customers**: In the case of service companies (e.g. petrol stations, retailers and tennis courts, etc.) being close to customers is a primary requirement. However, in the case of services available online, location is exclusively determined by the qualification and costs of human resources (see Indian *call centres*). In operations firms delivery costs have to be compared to manufacturing costs, and their best combination must be chosen. In the last few years, more and more American companies manufacturing in China have moved back to the USA because wages in China are gradually increasing and with the delivery costs included they can reach or might even exceed costs of the operations taking place near consumers' market.
- **Local inhabitants:** some people welcome companies moving their operations to their town (e.g. creating new jobs, development of infrastructure and increase of tax revenue, etc.) while other are afraid of its possible negative effects (e.g. environment pollution and noise pollution, etc.). It usually sparks off considerable debate when an organisation moves its operations near certain towns, which might have even more frightening negative effects (e.g. a nuclear power station, a prison, a landfill or a military radar, etc.).
- **Labour force**: Most multinational companies choose their seat in the world according to the qualification and price of labour force. Such factors are taken into considerations as wages, training and qualification of labour force, work culture and work ethics and organisations of labour force (the presence and bargaining powers of trade unions).

[56] Wikipedia: Just in Time, http://hu.wikipedia.org/wiki/Just_In_Time

- **Other factors**: include all factors that were not mentioned above. For example, life quality, crime rate, schools and recreational facilities, traffic, building costs, the character and strength of market competition, etc.

The goal of Audi is "to be to the customer as close as possible", for example on the markets in North- and South America and Chin, which produce considerable sales increase. Due to the economic plant size, a correct strategy is that the world market is supplied with particular models from one plant. (For the time being, A3 Limousine, A3 Cabriolet as well as TT Coupe are manufactured only in Hungary (mno.hu 24 July, 2014).

6.2.4 Operations process improvement

An interesting manufacturing principle is Lean, according to which all functions and tasks must be eliminated that do not create values for the customer.)

The term Lean management is originated from its comparision with the traditional, i.e. classic mass production system. Lean creates (more) value for the customer by using fewer employees, fewer resources, less time and less space. (Losonci 2010)

"Toyota's philosophy about the necessary place for a given operations volume is just the opposite of that of GM. Toyota believes that communication between employees becomes easier by using the smallest possible place as well as there is no place for stocks. In contrast, GM believes that further space is needed for repairing faulty vehicles, and storing large quantities of stocks which ensure the smooth flow of operations. The examination of assembly line reveals further differences. In Toyota City the stock available next to the workers was less than what is sufficient for one hour. If a worker found a faulty spare part, he labelled it carefully and sent it to the department of quality control so that this fault would not happen again. At GM the semi-finished products were piled up next to the work place – in some cases in a quantity sufficient for several weeks. There were packaging materials and waste material strewn around next to the work place. Unused spare parts usually landed in the bin. At GM work on the assembly line was unevenly distributed with some employees running up and down crazily while others had time for smoking a cigarette or reading newspapers. At Toyota the spare parts got more smoothly to their place and work was distributed more evenly. Consequently, every

employee worked at about the same speed. At GM the assembly line can be stopped only by a senior manager, even he can only cite work safety as a reason. The line still stops regularly due to a technical breakdown or supplier's fault. In In spite of the fact that in Toyota City anybody can stop the assembly line, it hardly ever happens because problems are dealt with previously and one fault does not happen twice." (Jenei, 2009)

Six sigma was developed by Motorola in the 1980s, and later it was adopted by several big companies such as General Electric.

Six sigma is a quality assurance system which facilitates the stability and calculability of company processes. It means that the failure rate should be less than 3,4 in 1000.000.

It is as if a football goalkeeper let in a goal only every 300 years or his work was 99,99966%- free of defect.

Six sigma refers to a company operations method based on statistics theory. In statistics sigma is an indicator which shows how much variation there is from the average. In quality management, sigma measures the variability of the process, and thus it is used for measuring the performance of the process. How much did we manage to achieve a defect-free result? Everything that leads to consumers' dissatisfaction (a product or service that does not meet customers' needs and a too high cost level, etc.) is a defect. Companies usually work at a defect level between 2-3 sigma. If it succeeds in raising performance to a higher level than this, cost saving also appears in addition to customers' satisfaction by reducing the rate of losses and reprocessing. Six sigma is a company philosophy which focuses on satisfying customers' needs, and trying to realise that profitably.

6.3 SUMMARY, QUESTIONS

6.3.1 Summary

Operations management deals with analysing, planning, implementing and controlling operations and service processes. It involves the responsibility that the business processes should function effectively, and thus the company should use the fewest possible resources by which even product criteria, consumers' needs can be fully satisfied (see "lean" management, TQM, JIT and JIS.

In addition to marketing and finances, operations refer to the company's strategic function, which deals with producing market offerings (manufacturing and offering services). In depends mostly on the operations management to what extent products and services meet the identified target market needs, the expectations of marketers, product developers, and thus whether the company will be able to survive in the long run.

In simple terms, operations management is concerned with processes which turn inputs (raw materials, labour and energy, etc.) into outputs (products and services). Operations managers continuously improve manufacturing processes on the basis of performance indicators and customers' feedback. Operations have a very close relationship with the departments of marketing, sales and research-development. Operations managers spend most of their time communicating and negotiating with marketers, customers and research-developers (according to a survey).

6.3.2 Questions for self-assessment

1. What are the three strategic functions of a company and how are they related?
2. How is operations management interpreted?
3. What is the difference between strategic and tactical decisions? Give examples for it in connection with operations management.
4. What is the difference between intermittent and repetitive operations processes? Give examples.
5. Enumerate the most important decisions related to operations.
6. What questions are raised by quality and quantity in operations management? Give examples.
7. What factors influence the decision of companies related to location?
8. What is TQM?
9. What does know-how mean?
10. What does lean management refer to? What is the difference and similarity between JIS and JIT?

6.3.3 Practice tests

1. In addition to marketing and finances, operations are the third strategic function of organisations. T/F
2. Tactical decisions influence the company's resources in a shorter run that strategic decisions. T/F

3. Supply chain also covers the supply processes preceding manufacturing or service offering. T/F
4. Operations management comprises several planning, managing and controlling processes, the aim of which is to get the product to the customer. T/F
5. In the case of services operations management cannot be interpreted. T/F
6. Factories operate by means of intermittent processes if they manufacture various kinds of products, or if they have to adapt to individual expectations of consumers. T/F
7. The most important danger of technological investments is the high fixed cost. T/F
8. During operations processes the movement of products can be stopped, and a certain quantity of products appear in the halt, which is called dead weight. T/F
9. When determining the ideal location of the operation, closeness to suppliers is more important that closeness to customers. T/F
10. According to the principle of lean all company activities must be eliminated which don’t create value for customers. T/F

7. PROVIDING RESOURCES: FINANCIAL DECISIONS (A. NOVOTNY)

7.1 OBJECTIVES AND COMPETENCES

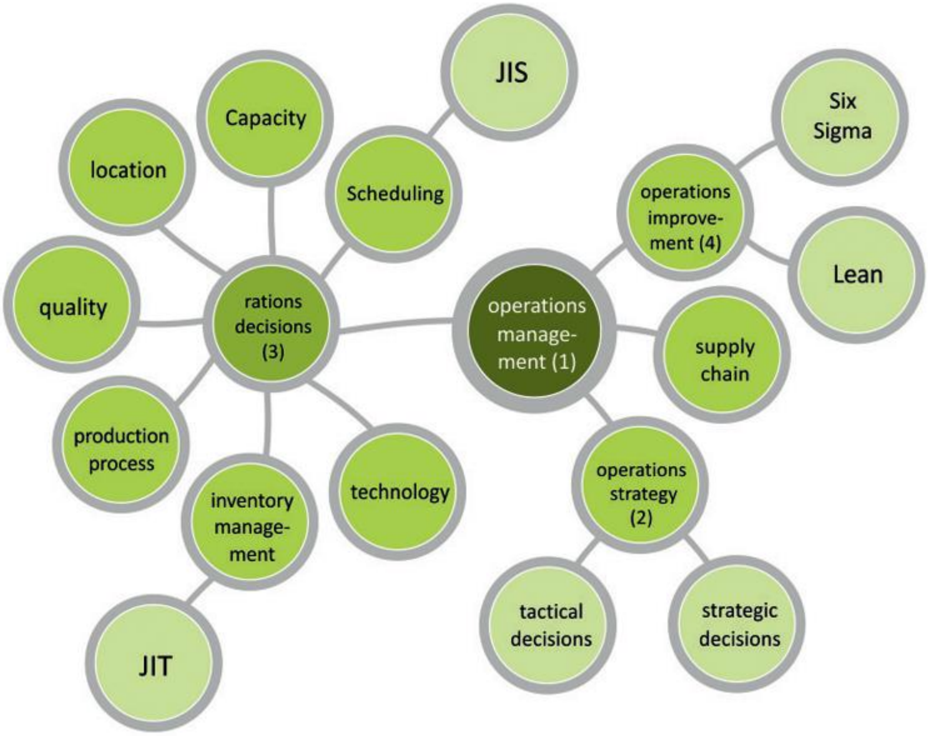
As was mentioned in the previous lesson, in addition to operations, finances are the other strategic function of organisations, which have an impact of profitability in the long run. Financial decisions are of fundamental importance not only in the life of companies and businesses but in the life of individuals and the country as well. Let us think, for example, of the overborrowing of real-estate loans and credits in foreign exchange, which have driven to bankruptcy and into near bankruptcy not only households but companies and banks, even whole countries at the end of the 2000s.

Every organisation and organisational unit has to face financial barriers as their scope of action is fundamentally influenced by how large budget they have at their disposal to transact an investment, a development or a project. In addition to top managers, it is important for middle managers as well to understand the world of finances since they will have to communicate convincingly why their unit needs more or differently timed resources. The main person responsible for finances is the chief financial officer (CFO), who besides the chief executive officer of the company (CEO) has to take responsibilities for purchasing and using financial resources needed for the operation effectively.

In this lesson students will understand what fundamental decisions organisations have to make, and how they influence the operation, profitability and wealth of a company. They will be able to make a distinction between investment and financing decisions, and they will understand the connection between them. They will familiarize with the details of a financial report and the importance of cash-flow. They will understand the role of the financial manager and will be able to enumerate the principles of finances.

Hearing the word finances, people usually think of a narrow field, the stock exchange, the world of bonds and shares. However, finances comprise the smallest transactions of the company as well (think of the continuous book-keeping and paying invoices) In addition to having professional knowledge, analytical competence is also necessary to make financial decisions, and consequently this lesson is also aimed at developing analytical way of thinking. Besides analytical competences, the ability of making decisions independently, “finesse” is also important as in the real world we rarely have all the necessary information at our disposal; we have to face quite a lot of uncertainty in the business environment as well. Consequently, finances deal mainly with collecting information and its interpretation.

7.2 COURSE MATERIAL



29. ábra: Concept map

7.2.1 Types of business organisations

The finances of business organisations can be considerably different according to what legal form they operate in. Therefore, it is worthwhile getting an overview about the best-known business forms.

Sole proprietorship is liable for the debts of the company solely and with its whole wealth as well as is entitled for its profit.

In this case there is no difference between the entrepreneur and the business: in a possible legal action the entrepreneur can lose his personal wealth (his house, car or savings). Sole proprietorship is common in the case of start-up businesses which are still at the beginning of their growth. Many “lifestyle” entrepreneurs are sole proprietorship, they don't even want to grow or exceed a size that is still comfortable and can be managed easily. Sole proprietorships use their own savings, loans given to them by family members and friends and mainly bank credits in their financial decisions.

- **Partnerships are organisations established by several persons, which can involve more resources in the business since the business partner offering the capital can become a proprietor: in return for his money, he can get a share in the business.**

The members can have limited or unlimited liability for the debts of the firm. Limited partnerships make it possible for a general partner to start a business by his ideas and qualification while a limited partner can enter only with a capital. As the limited member is liable for the debts of the company only up to their capital contribution to the business, a general member is liable for them with his personal wealth as well. The best choice for those who want to limit their liability completely is a **Limited Liability Company** - LLC).

- **A LLC forms an ideal transition between limited companies and corporations since proprietors are liable for the debts of the company only up to their capital contribution to the business and they do not have to choose double taxation, either.**

- **The form of business managing with biggest capital is a corporation, in which propriety and management are separated from each other.**

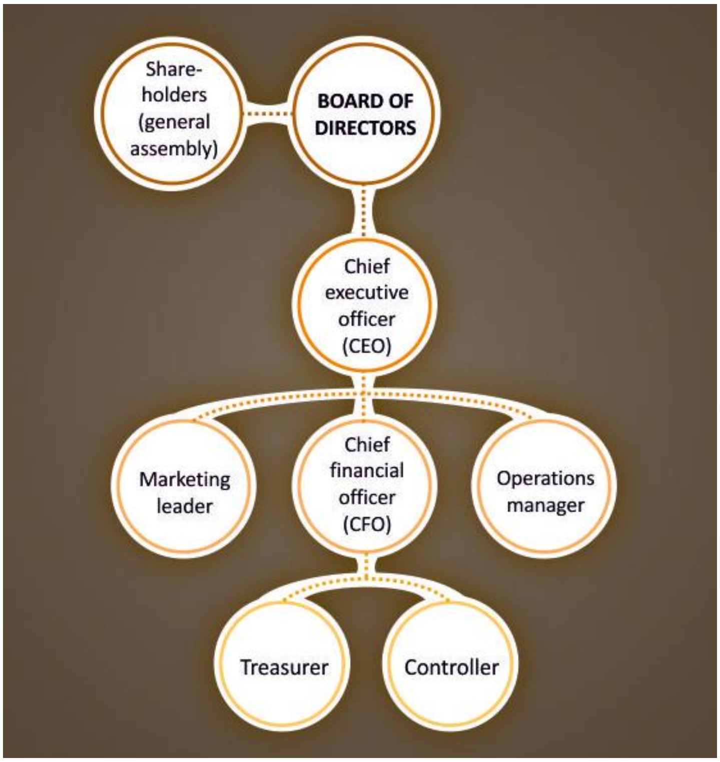
The biggest advantage of a corporation is that it can involve unlimited capital into financing the operation of the firm through issuing shares. Furthermore, the proprietors are liable for the debts of the firm only up to their capital contribution to the business and can relatively easily sell their proprietorship. The operation of the firm is not influenced if the proprietors change in the meantime. The corporation is supervised by the Board of Directors; they choose the management which manages the company. The main drawback of a corporation is the double taxation: on the one hand, the corporation pays corporation tax from its profit; on the other hand, the proprietors have to pay an income tax after the dividend.

- At the general assembly the corporation decides on whether to pay the whole of or only a part of the the produced profit in the form of dividend or to put it into the result reserve. The sums placed in the result reserve will be used for investments or for paying later dividends.

- The most problematic field of the corporations' operation is that the interests of the proprietors and those of the management do not always agree (*agency problem*). While the manager tries to maximize his own benefit (income, career), the proprietors the price of shares. Of course, the two often coincide, but not in every case. Let us consider the extreme case when the manager conspires with the proprietors of another company, who want to buy the firm managed by him at a cheap price. Furthermore, many managers expect to get a high salary and a luxurious way of life (a company flat, car and holidays, etc.) even if the company is not performing well. Thus, the role of the Board of Directors is very important to supervise managers.

7.2.2 The chief financial officer

In the case of sole proprietorships and smaller limited partnerships mainly the proprietors are responsible for financial decisions. However, bigger organisations, whether profit-oriented or non-profit, usually operate an independent department for finances and accountancy. Although the financial (or economic) manager is responsible for financial decisions affecting the whole company, department leaders of bigger organisations also have to know a bit about finances.



30. ábra: The place of CEO within the organisation (based on Keown et al. 2008)

The financial manager of a company must know both how the company operates (e.g. he must be familiar with the company strategy) and must have a special knowledge in the field of finances and controlling. The responsibilities of financial managers include aligning resources to investments, acquiring financing resources at the best possible conditions, determining the structure of resources, and managing operating assets (e.g. stocks and cash balance). Thus, the chief financial officer distributes company resources among various projects by making sure that the company should be able to operate in the short run but that the best projects creating a foundation of the future should receive the necessary support. Furthermore, he controls the financial activity of the organisation and provides the top managers of the company and the Board of Directors with the information necessary for decisions. He also has to take the responsibility for **the financial report** of the organisation.

- The financial manager is called CFO (chief financial officer) in Anglo-Saxon countries, in Hungary the term financial manager is used. In bigger organisations the controller and treasurer are subordinated to the CFO. The treasure is primarily responsible for financial tasks (investment and financing decisitions), the controller manages controlling activities (e.g. preparing the financial report).

7.2.3 Financial report

Every firm is obliged to prepare its financial report at least once a year. The financial report is a formal record of accountancy, which describes what the financial position of the company is like. The financial report also helps the proprietors, employees, creditors and investors of the firm in making decisions related to the company.

The report consists of several parts. One of its parts is the **balance sheet,** which can be divided into two parts: assets and resources. The balance sheet details the various wealth elements of the organisation. Another part of the report is the **income statement,** which compares the incomes and expenses of the firm. In addition to the balance sheet and the income statement, the cash-flow must also be presented (**cash-flow statement)** as well as in the appendices the operative data of the firm's operation must be detailed. The report is made available for public, and can be downloaded electronically about each firm.

- **The balance sheet is a record which describes the structure of the assets at a given point in time as well as the financing resources of these elements of assets.**

- An asset can be a property, a lorry, a computer, raw material or securities bought, and their resource can be credits, loans, bonds sold, shares or the proprietors' capital contribuition to the business. The value of assets is always equivalent with the total value of resources as whatever the company buys, it must be paid for from some kind of a source.

- **The income statement details the incomes and expenses of a given period of time (typically a business year) and as their difference the profits and losses of the business. The purpose of the income statement is that the persons concerned (proprietors, investors and lenders) can assess the performance of the company in a given period of time; draw conclusions from this about its future performance, and assess future risks as well as make decisions on the dividend payment.**

- The connection between the balance sheet and income statement is meant by **the result according to balance**, which is, on the one hand, the result of the given period of time, and on the other hand, the asset change that can be shown on the bank accounting date of the given period of time.

- **Cash flow means the process of accumulating and using resources during a definite period of time (Cash flow = cash inflow – cash outflow). It value is equivalent with the difference between the actual cash inflows and the actual cash outflows. In financial terms, a company can be considered to be healthy if it is able to produce enough money to pay its creditors , employees, suppliers and proprietors.**

- While in the income statement there cannot necessarily be found money movement behind certain items as the relevant incomes and expenses are not always realised in the examined period of time, there is real money movement, money flow behind the items in the cash flow statement.

- The most important function of the cash flow statement is that the management can see numerically the consequences of previous decisions, and the impact of decisions on the stock of financial resources. From the income statement it turns out if the operation incomes provide for the internal money need, or the necessary amount of resources must be provided by issueing shares and bonds, perhaps by credits. Cash flows are classified as operating cash flows and cash flows from investing and financing activities.

- **Operating cash flow shows the change in finances (e.g. income from sales, paying suppliers, paying wages and depriciation) resulting from the normal operative activities of the business (e.g. product sales and offering services)**

- **Cash flow from investing activities shows the cash flows and the relevant changes in finances related to the long-term investments of the business (e.g. physical resources, immaterial goods and long-term securities) as well as to the selling of invested resources.**

- **Cash flow from financing activities shows the changes in the size and structure of the company's own capital, the loans and credits taken out. The financing cash flow with a too high positive sign refers to involving considerable external resources.**

Cash flow is a very good performance measure, which shows how much money is produced by the company. Not a single firm can survive in the long-run if it cannot produce money. In the short-run it can continue for some time, e.g. the firm takes out credits, delays payments, but sooner or later it will get into trouble. Thus, a good company and a good investment is what produce money.

- Accounting gain or profit can be misleading as it does not mean money that can actually be spent. The problem is that there are several categories of accountancy profit. The result of operating activity is the result from the basic activities, the result of financial transactions is the balance of financial incomes and expenses; the usual business result is the joint balance of the operating-business result and the result of financial activities; the taxed result is the part of the result prior taxation reduced by the corporation tax; the result according to balance sheet is the taxed result reduced by the dividend. Thus, accounting result can be "manipulated", for example, if the company wants to increase its yearly profit by reducing certain expenses, or it wants to decrease it by increasing the expenses.

7.2.4 Investment and financing decisions

In simple terms, financial decisions are about how to get money and how to spend it. The former is called financing decision. In other words, investment decisions are about capital budgeting, the financing decisions are about capital structure. The primary goal of a company's investment and financing decisions is to maximize the shareholder value.

Investment decisions

- **Investment decisions are made on capital budgeting. In it the company examines whether it is worth financially executing its planned investments (e.g. building a new plant). Most organisations try to buy assets which increase the value of the organisation to the greatest extent.**

Investments must meet the following criteria:

- they must maximize the value of the firm,
- they must take the risk of investment into consideration and
- they must find a suitable way of financing for it.
- If there isn't an investment decision meeting the three criteria above, the resources must be given back to the shareholders.

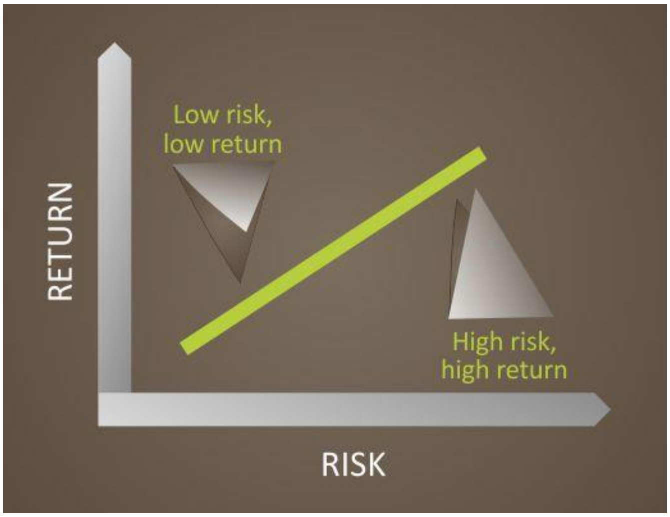
Investment decisions deal with how we should spend our money on means of production in such a way that it should yield the greatest income (gain) for the company in the given time span. In other words, what assets the company should buy so that the value of its shares would increase to the greatest extent.

A further goal of investment can be to increase the incomes of the firm, to decrease its expenses, to comply with laws, proceedings instituted by a public authority, and possibly to replace obsolete, worn out assets. Investments are of different type on the basis of their **riskiness** and **the information necessary for the decision**.

- It is characteristic of most investment proposals that they involve considerable expenses, the gains accumulating through investment appear later, and are not fully known. They determine the technical-technological features, the economic and financial position of the firm in the long run. Bad investment decisions are irreversible in many cases, or they can be corrected only by considerable expenses.

- **Risk in finances means the probability that the actual return of the investment will be lower than the expected return.**

Therefore, the greater return (reward) the investment promises, the riskier (more uncertain) its return is. Approaching it from the other side, businesses promising a higher return are probably rather risky. If investors are aware of this principle, they cannot experience much disappointment.



31. ábra: The risk-return relationship

As the resources of a company are limited, it is not possible and it is not necessary to realize all investments at the same time. However, the expected profitability of investments can be compared on the basis of several indicators. Of these the best-known indicators are **net present value** (NPV) and **internal return rate** (IRR). The NPV compares the present value of incomes coming from the investments to the present value of the expenses of the investments and states the difference between the two (profit/loss). The IRR means the expected increase rate of the investment –a greater expected increase rate means a better investment. Both calculations are partly based on estimation as there is no guarantee for the return of most investments.

Present value (PV) is a term of economics expressing the time value of money. It expesses how much 100 euros received in the future will be worth today. By reverse logic we can get to a similar term, the future worth of money: how much the value of present 100 euros will be at a given future point of time. The present and future value of money depends primarily on the bank interest rate or some kind of expected return. If the expected return (interest rate) is high, the future value of 100 euros will also be high while the present value of 100 euros received in the future will be low.

Money has time value, i.e. the money received today is worth more than the income tomorrow. Present money is worth more only if we invest it and don’t hide it under our pillow. Therefore, companies try to invest their free finances even for a shorter time, for example, in securities or bank deposits. Sellers also like it when customers pay in advance. What is more, customers who pay for the goods or service accurately and in advance are often given allowances.

You can find an example for how to calculate present value (PV and NPV) below: http://www.mathsisfun.com/money/net-present-value.html

The growth strategy of A MOL GROUP is to build a larger presence in the region, which it will do by buying up further pertol station networks (investment). You can read more about the more recent expansion of MOL below: http://www.tozsdeforum.hu/tozsde/reszvenypiac2/terjeszkedik-a-mol-a-regioban/

Financing decisions

While investment decisions cause changes in the assets of a company (size and structure) **financing decisions** transform the resources of the company.

The company has to find a balance between its short-term obligations and long-term goals. In very short term the company has to pay its bills, but at the same time it also has to pay attention to tying up (investing) its surplus resources continously so that they will possibly increase the value and capital of the company. The other extreme is also dangerous: if the company invests all its fortune and does not leave free sources for paying daily bills and short-term obligations, it will become insolvent soon. Consequently, companies have to find the right balance between their short-term and long-term financial decisions.

Financing decisions influence the source side of the organisations balance. They give an answer to what extent the organisation finances its assets (investments) by equity, long-term liabilities and short-term liabilities.

Assets = Equity + Liabilities

Financing decisions have primarily two types (Gyulai, 2013):

– using own sources and
– bringing in external sources.

The necessary sources can be obtained from within the company, for example, by keeping profit back. In such a case we can talk **about**

internal or self-financing. A special case of internal financing is "rearranging capital", when a company sells its asset becoming unnecessary, and buys other assets from the income resulting from it.

The other part of sources is obtained by the company from outside. External financing can come from the proprietors, who would like to have a share of the company's capital and income, or from creditors, who lay claim to an interest on the source that they provided. Creditors include commercial banks, leasing firms or suppliers if the products and services bought from them do not have to be paid for immediately. Creditors are market participants independent of the business, and therefore the creditors' financing form is also called foreign financing.

7.3 SUMMARY QUESTIONS

7.3.1 Summary

Finances appear as an independent subject or course material in most courses of economics, and therefore we have pointed out only the terms that we considered as the most important ones, – a more detailed discussion is beyond the scope of this lesson.

Summarising, finance is the study of how individuals, organisations and countries manage their financial resources. Finances are important because every individual and company encounters decisions related to obtaining and spending money.

Capital budgeting is called the process in which companies plan their long term investments and improvements. The basis of assessing investments is present value calculation. Long-term sources (equity, long term credit) by which investments are financed are called capital structure. Working capital management deals with short term assets (current assets) and resources, and try to ensure that the organisations have enough financial resources at their disposal for their daily operation.

It is possible to assess organisations' financial processes and financial state on the basis of the cash flow statement, income statement and balance sheet. The cash flow statement shows the quantity of the cash available, the income statement shows profits and losses while the balance sheet shows the company's capital. Of cash, profit and capital it is perhaps cash that gives the clearest picture of a company as accountancy profit or loss is a too complex category, and not only the quantity of capital but the way of how it is used is also important, which eventually manifests itself in cash flows.

7.3.2 Questions for self-assessment

1. What business forms do you know? What are the primary characteristics in which they are different from each other in terms of their finances?
2. What are the main responsibilities of the organisations'' chief financial officer?
3. What are the parts of a financial report and what do they contain?
4. Which part of the financial report gives the most accurate picture of the financial situation of the business and why?
5. What types does cash flow have?
6. What is the difference the investment and financing decisions?
7. What indicators do you know for comparing the profitability of various investments?
8. Why is the time value of money important in financial decisions?
9. How could you characterise the risk-return relationship?
10. What is the difference between internal and external financing?

7.3.3 Practice tests

1. In which of following business forms is the proprietor liable for the business's debts only to the extent of his capital contribution to the business?
   a) sole proprietorship
   b) general partnership of limited partnership
   c) LLC
   d) none

2. In which organisational form does the problem of double taxation arise?
   a) sole proprietorship
   b) limited partnership
   c) joint venture
   d) corporation

3. Who of the following are the highest level managers of a corporation?
   a) shareholders
   b) top management
   c) the CEO and CFO
   d) the members of the Board of Directors

4. What does "agency problem" refer to?

a) that the corporation has to pay both a profit tax and a dividend tax at the same time
b) that the management and the proprietors of the corporation are not the same
c) that the sole proprietorship is liable for the firm's debts with its own wealth as well.
d) that the Board of Directors is chosen by the shareholders

5. All, but one of the following responsibilities are those of the treasurer's. Which one is the only exception?
   a) preparing financial reports
   b) cash management
   c) credit management
   d) financial planning

6. The three types of which financial report are operating, investment and financing?
   a) balance sheet
   b) income statement
   c) cash-flow
   d) appendices

7. Which financial report shows whether the organisation is profit-making or loss-making?
   a) balance sheet
   b) income statement
   c) cash-flow
   d) appendices

8. Which criterion of the following must investments meet?
   a) must maximize the firm's value
   b) must maximize risks
   c) must maximize future cash flows
   d) all three are true

9. Which of the following is not an asset?
   a) immaterial goods
   b) animals for breeding
   c) substances
   d) loan obtained

10. Which of the following does not belong to the principles of finances?
    a) the time span of investments
    b) the importance of cash flow
    c) the risk-return relationship
    d) the time value of money

8. MARKET FOUNDATION OF OPERATIONS: MARKETING (A. NOVOTNY)

8.1 OBJECTIVES AND COMPETENCES

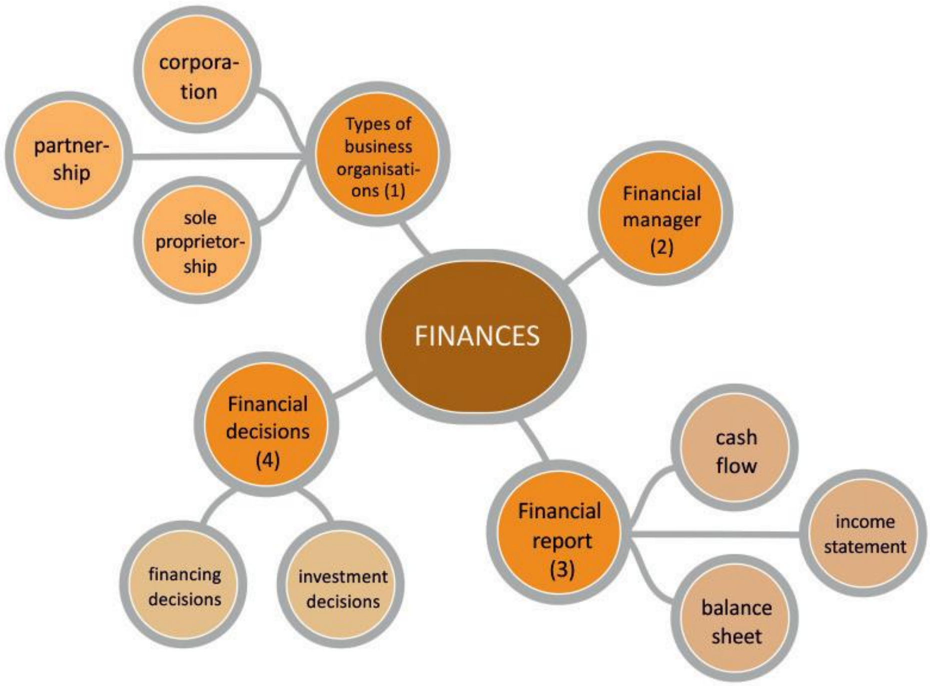
Besides operations and finances, marketing is the third strategic function of companies. The aim of this lesson is to present the main activities and most important concepts of marketing; and at the same time to develop marketing point of view and customer centered thinking.

In this lesson students

- will get acquainted with the basic concepts and means of marketing and recognise their importance for the successful, long term operation of organisations,
- will study the main steps and processes of marketing activities,
- with special emphasis on creating and planning a marketing programme assisting strategy, which primarily influence the long-term use of resources.

The main objective of the course is to enable students to recognise: marketing is a comprehensive organisational activity, which has an impact on every activity of the company and it has an especially strong relationship with operations (services) and finances. Corporate strategy and marketing strategy that can be derived from it show the organisations what resources (and in what quantity) they need to achieve their market goals. Consequently, marketing plays a role of coordination between company functions as only by considering the activities planned to meet customers' needs is it possible to give an answer to the questions related to operations, human resources, finances or purchasing raw materials.

8.2 COURCE MATERIAL



32. ábra: Concept map

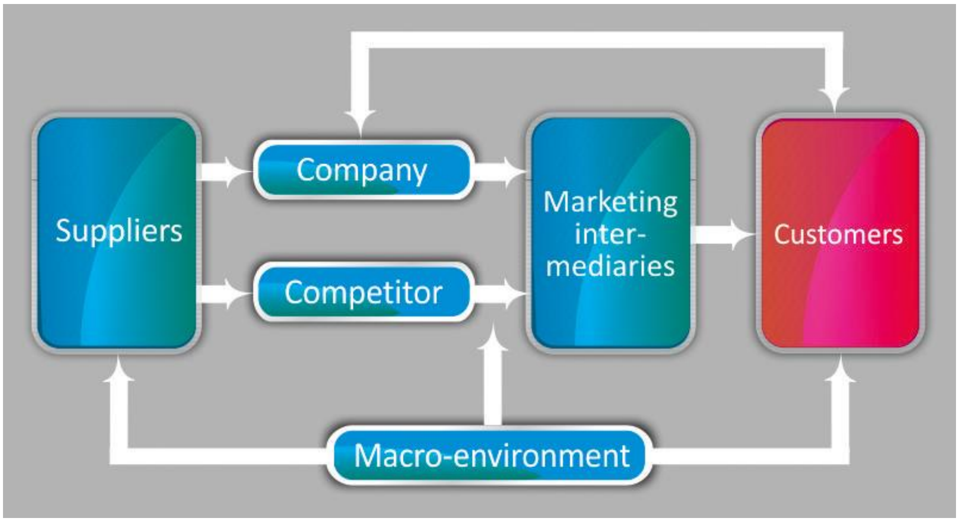
8.2.1 What is marketing?

In simple terms, marketing means meeting customers' needs in a profitable way. Marketing has two goals: to win new customers, and to keep old customers. As it cannot be imagined that any organisation could survive without customers or clientele, the importance of marketing has been proved right now. If we had to point out what the most important aspect of marketing is, we would lay the emphasis on understanding customers' needs. In the view of many people, marketing is equivalent with customer centered thinking, it could be said that it is a company philosophy which places the customer into the centre. In professional terms, marketing is a co-ordinated system which includes planning and implementing the activities related to the market.

According to the definition of the *American Marketing Association,* marketing is the activity, set of institutions, and processes for creating, communicating, delivering, and

exchanging offerings that have value for customers, clients, partners, and society at large. (July 2013).

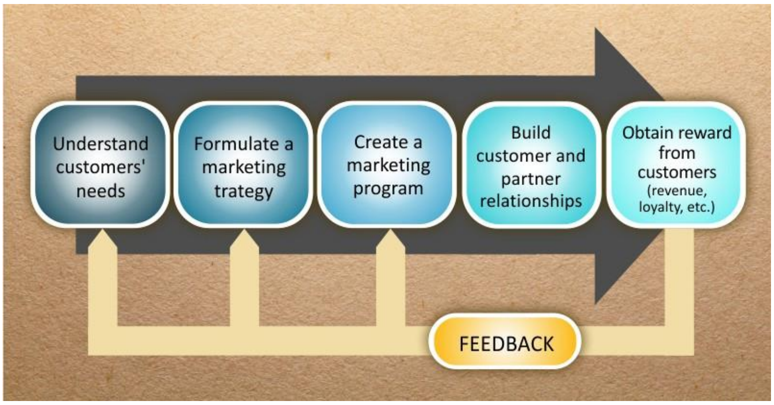
Organisations do not function in a vacuum. A company tries to develop a profitable customer relationship not by itself but by co-operating a whole range of business partners. Competitors even try to hinder the company in it. By co-operating with the other departments of the company, suppliers, marketing mediators and customer, and by taking the offerings and strategies of competitors into consideration, marketers have to meet market needs. While doing so, the company and its partners are working in a greater field of force, in the so called macro-environment, which comprises the broader economic, social, political, legal, technological and environmental factors.



33. ábra: The marketing environment (Kotler & Armstrong, 2006)

We can understand marketing the best when we look at what activities encompasses. These are the following:

1. Understanding customers' needs.
2. Developing a customer-oriented marketing strategy.
3. Designing a marketing program.
4. Building customer and partner relationships.
5. Taking reward over from the customer.



34. ábra: The process of marketing (based on Kotler & Armstrong, 2006)

Understanding customers' needs Developing a marketing strategy Designing a marketing program Building customer and -partner relationships Taking reaward over from the customer (income, faithfulness, customer equity)

8.2.2 Customers

An organisation can hardly be successful without understanding customers' needs. But what do we mean by need?

Need is a feeling of want which entices you to act, to buy.

Our primary needs are, for example, appeasing hunger and quenching thirst. A higher level need is our desire for safety, love and self-actualization (see Maslow's hierarchy of needs).

Needs are given and they appear similarly in every person and society. Companies cannot influence them or they can do so only to a small extent. In contrast, needs are different country by country, customer by customer.

Want is a need influenced by culture and personality.

While a hungry Hungarian student wants to have a slice of breaded meat, mashed potatoes and a slice poppy seed or curd cake, an American student wants to get an American hamburger, French fries and cookies. Big companies are able to transform needs, for example Mac Donald's has achieved that many Hungarian students should desire to have hamburgers and cokes when they are hungry.

Demand is the solvent want appearing on the market.

Many of us wound have a want for an expensive sports car but it doesn't interest the Ferrari factory. They deal only with solvent customers.

The customer will choose the offer which represents the greatest perceived **customer value** for him/her.

Customer value is the difference between all the perceived benefits of the product (use-value, recognition from friends, etc.) and all the perceived costs (money, time and energy spent purchasing it).

The concept of customer value can also be approached as the difference between the benefit expected by the customer from the product and the benefit perceived while it is used. Customer value can be increased by every single characteristic of the product, but the product can bring less tangible benefits for its buyer as well. For example, drinking a coffee with friends might cost as much as the coffee bought for takeaway, but due to the experience customer value is bigger in the former case. In addition, a professional coffee machine bought for home use offers both quality and comfort at the same time, which increases customer value compared with a café in the city centre if we want to save time (and money).

The customer will be **satisfied** with the product if its performance meets his/her expectations, but he/she will only be faithful to the company if the performance of the products exceeds his/her expectations.

A satisfied customer is faithful to the company and increases the so called *Customer Lifetime Value - CLV,* i.e. the net present value of the sum of products and services a customer bought at the company.

CLV is the present value of the customer expressed in money. It makes its calculation difficult that one part of customers "disappears" in the meantime, leaves the company and its products (*churn rate*), and they might return later. Thus, the value of customers in money cannot be given with full certainty. As the first step, it is worth estimating the remaining customers' life expectancy (in years). After that, we predict the customer's future spendings on the basis of the expected products and prices of our firm (income). Next, we predict he expenses of manufaturing and selling the products and services, and the expenses of keeping the customer in the following years. Finally, we must calculate the difference of these future expenses (incomes –expenses) year by year, and determine the simple and accumulated present value of the profit and loss by means of discounting.

You can find an example for calculating CLV here:http://www.dbmarketing.com/articles/Art251a.htm

By calculation CLV, we can identify our most valuable customers and thus, we can spend greater energy and costs on keeping them. It doesn't "hurt" the company to lose customers with a negative CLV. Before introducing marketing programs, it is worth calculating what impact they will have on keeping customers, the quantity of customers and on the CLV by these. Consequently, CLV can be a very useful tool for companies, the calculation of which is not too complicated and expensive. CLV highlights the approach that a customer is not only a one-time transaction for the company, but a valuable long-term relationship. Related to it, see:

http://teszt.vg.hu/hbr/a-marketing-ujragondolasa-326488

Customer equity is the sum total of the CLV-s of all customers.

Among others, estimating customers is also important as acquiring a new customer costs about five times more than keeping an old one, therefore great emphasis must be laid on long-term customer relationships (see CLV philosophy).

8.2.3 Marketing strategy

Marketing strategy means higher level decisions which deal with choosing the target market (range of customers, clientele) and formulating the offer of the company.

In marketing **strategy** gives an answer to questions like "What customers should we serve?" and "How should we serve customers in the best way?". The responsibilities of managers are to create the strategy, mostly about how the organisation can build and maintain a profitable customer relationship. The company has to decide on who its customers are and how it can provide them outstanding value. An important part of strategy is the value offer, which is the sum of product advantages which the company promises to satisfy selected customers' needs.

To put is simply, strategy gives an answer to how we can achieve our goals. The company must formulate the goals to be achieved as clearly as possible. Instead of "increasing turnover" we should put down in which consumers' segment (e.g. young women), to what extent (e.g. by 10%) we wish to increase purchases until a given future point of time (e.g. the end of the year).

While creating a strategy, the company can follow various philosophies; it can put, for example, **the operations, the product, the company, the customer or the society** into the centre.

The approaches mentioned above also illustrate the diachronic development of marketing despite the fact that we can meet all five company philosophies or orientations even today.

35. ábra: Basic business orientations

According to one of the oldest views, customers give preference to products that are available in a great variety and cheaply.

Operations-oriented companies set the goals of achieving high productivity (high product/expenses rate), low expense rate and wide distribution.

In China, for example, where there is plentiful and relatively inexpensive labour force available, several companies take the operations oriented view.

Product-oriented companies try to manufacture the best-quality, most innovative and high- performance product.

The danger of this approach is that while the company managers are fascinated by the product, they forget about real customers' needs ("marketing myopia"). A product with a better performance on paper will only be successful on the market, too if customers find them more useful than other products to solve their problem.

It is not sure that a technically better pencil-sharpener will sell better on the market because it is possible that the customers are *looking for a different solution to solve their problem, for example, a Rotring pencil, a pen or a computer.*

Several companies suppose that there is not enough demand for their product if they do not encourage customers in the proper –often violent way to purchase it. It is mostly typical of firms selling products the purchase of which customers rarely think of (insurances, expensive food supplements or a burial place. etc.).

Accordingly, sales-oriented companies apply aggressive sales techniques (personal visit, persuasion, convincing and machine-like repeated messages.

The goal of a customer-oriented company (marketing conception) is to get to know customers' needs, and to satisfy them better than the competitors.

A customer-oriented company does not look for suitable customers for its products, but it looks for suitable products for its customers.

A good example of customer-oriented view is the computer manufacturer that instead of manufacturing the best computer makes it for its customers possible to choose the specification that their computer should be installed with; or a university where students can do their timetable themselves and name their major. A marketing-oriented company knows better what customers need than the customers themselves.

The most developed company view is **societal marketing** which calls our attention to thinking in the long run and maintaining life conditions through generations.

A society-centered company develops a strategy which improves not only the consumer's but the society' well-being as well, i.e. it takes the aspects of both environment and health into consideration.

8.2.4 Marketing tactics

Tactical marketing follows from strategy as such details as technical specifications of a product, packing, price reductions offered, sales packaging and brand slogan must also be defined here. The tactical elements are aimed at achieving strategic goals. In fact, tactics means defining the elements of the marketing mix.

Marketing tactics follow the creation of strategy. It comprises the definite features of a product, its price, the ways of how the

product gets to the customer and the applied techniques of promotion.

After the marketing strategy has been developed, the tactics, i.e. the marketing mix will be defined.

The marketing mix or 4Ps is perhaps one of the best-known part of marketing, which was introduced by the American *E. Jerome McCarthy* (1960) into the science of marketing. *McCarthy* classified the whole range of decisions related to marketing into four main groups; he made a distinction between decisions related to the Product, the Price, the Place and the Promotion.

36. ábra: Marketing-mix decisions

If we compare marketing with cooking, the 4 Ps are as if we gave the rate of the main ingredients (e.g. milk, eggs, flour and sugar) by them: the quantity of the ingredients in relation to each other must be carefully chosen according to the customer's taste. In the case of a luxury product (e.g. Louis Vuitton bogs) the price is set at such a high price which is unachievable for most customers. Furthermore, the product can be bought exclusively at exclusive brand sellers (place). The marketing communication elements (e.g. advertising, personal selling) must also reflect the high quality.

Some people think that the 4Ps are a too much company-oriented approach, and therefore *Robert F. Lauterborn* turned it to a customer-oriented approach in 1993 and created the "**4C" model**:

- Consumer,
- Cost,
- Communications and
- Convenience.

Customer is a better expression than product as the most successful companies start from customers' wants and needs, and not their products. In *Lauterborn's* model price is replaced by "cost", because price is only one of the cost elements for the customer. Buying and using a product involve several other costs, such as time, risk (response of friends) or even conscience. While promotion is manipulative, "communication" is co-operative, and thus it expresses the two-sided interaction with the customer better. Place is nowadays not as important as "convenience", mainly if we consider the possibilities provided by the internet: the interest of customers is gathering information comfortably, shopping and paying while the place of shopping starts losing its importance.

☸ Think of your favourite product or brand. Characterise it with the help of the 4P-s (product features, price, places of distribution and methods of promotion)!

In the case of services we can talk about not four but two marketing tools: the traditional 4Ps; and "People", "Process",and "Physical evidence".

Planning the marketing-mix based on the corporate and marketing strategy begins by developing the market offer (product). That's why of the elements of the marketing-mix, we will deal only with the market offer in what follows here.

The product

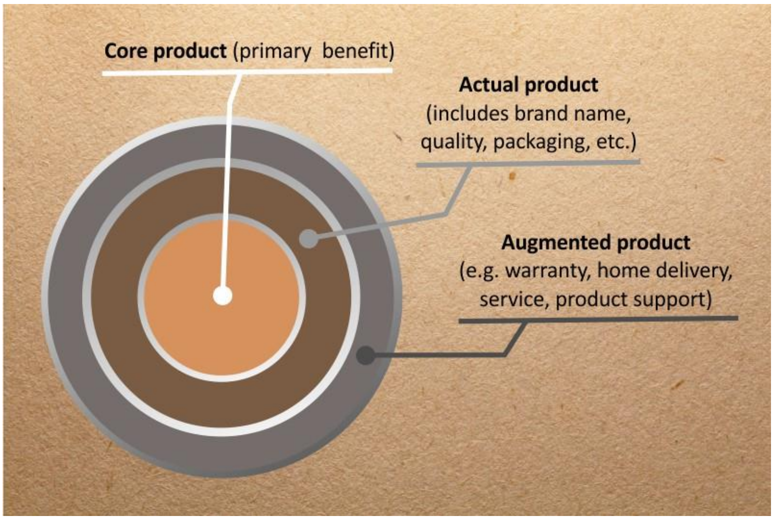
An offer has two extremes: it can be product in 100% (e.g. soap) and it can be service in 100% (e.g. examination by a doctor). Most offers can be found between the two extremes (e.g. a restaurant where we get both food and service).

A product can be anything – an object, a service, an event, a person, a place, an organisation, an idea, or their mixture –, that can be offered to customers in order to satisfy their needs.

🕮 **A service is an activity that somebody does in order to satisfy an other person's needs. Unlike a product, a service does not result in proprietorship.**

A product can be interpreted at three levels:

1. The core product: primary (abstract) benefit, which refers to what the customer really wants by buying the product (e.g. health).
2. The actual product that can be put on the shelf because it has a packaging, design, brand name and quality, etc. (weight loss pills).
3. The product augmented by services, which offer a full solution to the customer's problem (e.g. weight loss pills supplemented by dietary advice and a fitness season ticket).



37. ábra: The levels of a product

Products can also be grouped according to which market they are present on. The character of the products of the consumer market and the organisation market are different from each other in many cases.

Categories of **consumers products:**

– convenience products: we often buy them without consideration (e.g. milk, bread and sweets, etc.),

- shopping products: more expensive products from different aspects – price, quality, and brand – we think about it long which one to choose (e.g. a car, clothes, furniture, etc.),
- specialty products (called professional articles): have unique features, some customer groups make serious sacrifices for them (e.g. sport equipment, luxury cars, hotels and restaurants, etc.),
- unsought products: require much effort and communication (e.g. insurances, burial services and blood giving, etc.).

Types of industrial products (companies buy industrial products for further processing and doing business)

- raw materials or spare parts,
- buildings and machines,
- services (e.g. maintenance, legal or cleaning) and means (e.g. paper, feather, paint, nails).

When consumers buy most products, they consider and make decisions on the basis of different aspects. A company also has to decide about which product features to give preference to and how much to spend on one or another. Here the company has to compare customers' evaluation given on the given feature with its expenses, what it would cost to develop and ensure the advantage. It is not sure that customers would pay, for example, for a mini-computer built into a tennis racket, which does a statistical analysis about the accuracy of the player's hits. Therefore, many companies keep asking its customers how important they find certain product features and how satisfied they are with them.

Product features mean the most important field of competition and differentiation in marketing. The main product features are as follows: (based on Kotler & Keller 2012):

- **Quality**, which refers to being defect free or high performance (a Suzuki and a Mercedes can both be of good quality, but a Mercedes is not only reliable but comfortable as well. Furthermore, it offers a greater experience to drive it.). In general it can be said that quality is a quite subjective category; a product of good quality is the one that meets consumers' expectations whether it is durability, performance or smart design.
- **Design**, which increases not only the appearance of the product but its performance as well. (E.g. a design chair is also ergonomic).
- **Style,** which makes the product attractive for customers. A dress with a nice style can also be uncomfortable.
- **Brand**, which is the soul of the product.

A brand is a name, an expression, a sign, a symbol, a plan or the combination of these aimed at identifying the product or service and differentiating it from the product of competitors. In a broader sense, brand is everything that the brand means for the customer. Brand building- and management is the most important task of marketers. The brand exists in the customer's head. In fact, brand is the company's promise to offer definite product features, benefits and experiences in a balanced way.

The estimated value of the Apple brand is about 100 billion dollars, but Google is also worth more than 90 billion. The value of the Coca-Cola brand at the third place was 80 billion in 2013. Line extension and brand extension are easier for valuable brands as customers believe in them (e.g. Vanilla Coke, Diet Coke, Cherry Coke).

- **Packaging**, which has several functions. It is attention grabbing, describes and sells the product. Certain products have different types of packaging (e.g. tooth paste). As 60% of our purchases is impulse shopping, and we walk past several dozen products a minute in a department store, packaging is the last chance to influence the customer.
- **Label**, which is part of packaging, and thus it identifies, describers and promotes the product. On the label of foods it is compulsory to write its name, ingredients, allergenic materials, net quantity, expiration date, special storage conditions, nutrition content, additives used in the product, storage rules, name of manufacturer and place of origin.
- **Services after purchasing** are also of importance. Car dealers not only purchase cars but they must provide repair and maintenance services for their customers as well.

Services

The turnover of services is increasing enormously. Services create two thirds of the world's GDP. The service sector is not homogeneous. The state offers public service to citizens: it maintains courts, job centres, hospitals, an army, police, a fire brigade, posts and schools. Non-profit private organisations operate museums, churches and foundations, etc. Profit-oriented companies also offer a great many services. Let us think of airlines, hotels, insurance companies, retailers and telecommunication. The characteristics of the marketing of services can be summarised with the help of the HIPI-principle:

- **Heterogeneity**: the quality of services – compared to products – can change, greatly depending on who provides the service as well as when, where and how they are provided.
- **Intangibility**: the service cannot be seen, tasted, felt, heard or smelt (maximum its provider). Therefore it is important to give a fixed point, security to the customers and increase the trust customers have in the company.
- **Perishability:** services cannot be stored. We can get back the price of a hotel room or a plane ticket only if we have cancelled the service on time. The demand for most services is unbalanced. For example, how busy a restaurant, public transport, a hairdresser, a swimming pool or a tennis court is changes every time of the day or day. It is usually difficult to determine the necessary resources, and services often either overplan or underplan themselves. For example, in a restaurant more employees are needed at noon and in the evening, but even then you can never know whether a group of tourists pops in unexpectedly or not.
- **Inseparability**: services are produced and consumed at the same time and they cannot be separated from their providers. (only in rare cases, for example if telecommunication techniques can be used in the meantime); the employees are part of the service, offering a service is characterised by interaction.

New products

New product-marketing deals with planning, testing and introducing new products to the market.

A product can be new at world level, which creates a completely new market and customers. Such was, for example, the market of personal computers, mobile phones and tablets. However, most innovations are smaller modifications of a product already available, which most often results in brand extension. It is difficult to foresee which innovations will be revolutionary. However, continuous innovation does not only result in new products, it also compels competitors to follow our company.

Introducing new products into the market is not risk-free. In experience, half of them fail on the market. According to braver estimations, 9 out of 10 products do not live longer than three years. The reasons for that can be of many kinds ranging from strategic failures to tactical mishaps. Examples for these are misunderstood customers' need, overestimated market size, bad positioning, expensive development costs, improper design, price, distribution or communication. The strong response of competitors and insufficient profit can mean reasons why a product fails.

38. ábra: The process of product development (based on Kotler & Keller, 2012)

From the point of view of consumers, the product qualifies as an innovation which is regarded to be new from a certain aspect, independent of whether it is really new or not. Some people are more receptive towards new products while others show more resistance to them. First the customer gets information about the new product, which arouses his/her interest in a good case. After that he/she evaluates its advantages in relation to other products, perhaps he/she tries it, and then he/she becomes a consumer. Most products become known slowly, then the number of customers is increasing more and more quickly until it reaches a peak, after which customers gradually turn to other newer products.

8.2.5 Customer relationships

Building customer relationships is perhaps the most important element in marketing. A company acquires customers through customer relationship management (CRM), tries to keep them and increase their number. In order to keep customers, companies establish regular customers' clubs, use apply collecting actions and club cards, which reward frequent shopping. Many companies do not want to establish a good relationship with all customers any more, but they concentrate on customers that transact more sales. In CRM companies rely more and more on their internet possibilities, their interaction with customers and self-organising customers' groups. Social networking websites, the various blogs and forums make is possible for customers to advertise their favourite products, express their devotion or repugnance to them in order to participate in creating the brand, the brand image.

In a narrow sense, by means of customer relationship management (CRM) companies build an information database about shoppings and different interactions with customers. In a broad sense, CRM comprises all activities that a company does in order to acquire, keep customers and to increase their number. In this interpretation CRM is perhaps the most important activity in marketing.

Companies want to increase not only the number of customers (market share) continuously, but also their customer share, therefore they offer more and more products to customers. They try to entice them to buy such a wide range of products as possible.

8.2.6 Marketing results

In return for their efforts, organisations would like to get a **reward** from consumers in the form of money, market share, customer loyalty, and in a lot of other forms. Developing an outstanding market offer involves long-term benefits, and it increases customer capital. As it is more difficult and more expensive to acquire a new customer than to keep an old one, companies often try to increase their share within the customer.

Marketers are more and more often called to account to justify their expenses by financial data. As a result, companies start to lay great emphasis on measuring the results of marketing efforts. The marketing control process involves the following steps:

- setting marketing goals,
- measuring results,
- revealing the causes of the difference between goals and the actual result,
- making corrections.

Control has two types. One is the **operative control**, which means comparing continuously results with the yearly plan, goals performance measuring (e.g. sales quantity, profit and controlling the expenses of distribution channels). The other type is the **strategic control**, which means comparing strategies and possibilities from time to time as strategies and programmes can easily become out-of-date. One of the most important marketing performance indicators is the return on marketing investments.

Return on marketing investments (MROI) is the net profit generated by marketing investments in relatiion to the expenses of marketing investments.

The most obvious result of marketing investments (market assessment, payment of marketing staff, training of sellers, advertising budget) is the growth sales of and that of the market share. Several important marketing results are, however, difficult to measure (e.g. brand image and brand awareness). Therefore, companies examine their marketing performance by means of various marketing indicators. In addition to the usual indicators, more and more companies also apply customer-oriented index-numbers, such as customer retention, customer life cycle-value or customer equity. Their advantage is that they measure not only the current performance but the future potential as well.

Marketing expenses can be regarded to be an investment which result in profitable customer relationship. A greater customer value and customer satisfaction result in customer retension and an increase in their number, which finally have an impact on both customer life cycle-value (CLV) and customer equity as well.

8.3 SUMMARY, QUESTIONS

8.3.1 Summary

Marketing helps an organisation to achieve its market goals, and thus besides operations and finances, it is one of the most important company activities. At the beginning of the lesson we interpreted marketing and pointed out its importance in the business, non-profit and governmental sector as well. Then we focussed on the steps of the marketing activity: getting to know customers' needs, strategy creation, marketing tactics (marketing-mix), customer relationship management and customer recognition as a result of all those.

Planning a marketing strategy is the responsibility of company managers and marketing managers. It is worth planning the marketing strategy from corporate strategy (mission, goals and lines of business), and on the basis of the available external and internal resources as well. Marketing strategy comprises examining the company's environment (macro- and micro environment), getting to know the characteristics and wants of customers; and target market marketing, i.e. choosing the target-market, and positioning the offer for customers. Special attention must be paid to examining customers' behaviour as the key of success is to satisfy customers' needs in a profitable way. While some customers expect high quality and complete defect-free products, the most important criterion for others is the low price.

Marketing tactics comprise marketing tools by which organisations realize their marketing strategy: the features of marketing offer (Product and product development), the issues of developing prices (Price), the place and method of distribution (Place), as well as the promotion of the offer (Promotion). In the case of services, the 4P-s are extended by three new tools: people who offer the service (People), the process of the service (Process) and the physical characteristics surrounding the service (Physical evidence).

In fact, the customer is not interested in the product, but all the functional, social and psychological benefits that it can offer for him/her. The goal of most organisations is to increase not only their market share but also their share in customers, for which it is extremely important to build long-term customer relationship. Customers reward companies satisfying their needs beyond their expectations in several ways, for example, with money, loyalty or word-of mouth advertising.

8.3.2 Questions for self-assessment

1) What is marketing and why is important for organisations to a do conscious marketing activity?
2) Which marketing orientation (concept) reflects the most developed organisational way of thinking and why?
3) What is the difference between a need, a want and a demand?
4) What do we mean by a brand in marketing?
5) What is the marketing ROI and why is it important to measure it?
6) What levels of a product can we distinguish? Give examples for the various levels.
7) What main product features must companies make decisions about?
8) In what way are the 7P-s of services different from the 4P-s of products?
9) What are the steps of new product development?
10) In what way is the 4P view different from the 4C view?

8.3.3 Practice tests

1. All but one of the following marketing definitions are acceptable. Which one is not acceptable?
a) Marketing is creating value for customers.
b) Marketing is the profitable management of customer relationships.
c) Distribution and advertisement are the synonyms of marketing.
d) The basis of marketing is to satisfy customers' needs.
2. The goal of marketing is…
a. to identify consumers'needs.
b. to understand customers.
c. to sell products.
d. to advertise products.

3. Which of the following questions does marketing strategy give an answer to?
a. How do we achieve our goals?
b. What customers shall we serve?
c. How shall we meet customers' needs in a profitable way?
d. All three answers are correct.

4. The marketing tools used to implement the marketing strategy are called
a. promotion-mix
b. marketing-mix
c. CRM
d. societal marketing

5. What is the correct order of strategic planning?
a) goals, mission, lines of business, strategies of departments
b) goals, lines of business, mission, strategies of departments
c) mission, lines of business, goals, strategies of departments
d) mission, goals, lines of business, strategies of departments

6. The point of marketing is a definite series of three key activities. Which is the correct order of the three activities?
a) segmenting, choosing the target market, positioning
b) segmenting, positioning, choosing the target market
c) choosing the target market, segmenting, positioning
d) positioning, segmenting, choosing the target market

7. What do we mean by the current product in marketing?

a) the primary benefit, which refers to what the customer really want by buying the product.
b) the product that can be put on the shelf, which has packaging, design, brand name and quality, etc.
c) the product supplemented by services, which offer a full solution to the customer's problem.
d) the product that the consumer actually buys.

8. What do we mean by perishability in connection with services?
a) compared to products, the quality of services can considerably change, depending on who, where, when and how they are provided.
b) services cannot be seen, tasted, heard and smelt
c) services cannot be stored and put for a later time
d) creating and consuming a service happen at the same time, and in most cases it cannot be separated from its provider.

9. Which is the correct order for the steps of new product development?
a) idea generation, idea screening, concept development and testing, marketing strategy development, business analysis, product development, test marketing and commercialization
b) idea generation, concept development and testing, product development, marketing strategy development, business analysis, test marketing, commercialization
c) idea generation, concept development and testing , business analysis, marketing strategy development, product development, test marketing, commercialization
d) idea generation, concept development and testing , test marketing, marketing strategy development, business analysis, product development, commercialization

10. One of the most important concepts of marketing is CLV, which
a) refers to the product life cycle-curve.
b) refers to the sum of customers' needs.
c) means customer relationship marketing.
d) means the present value of customer expressed in money.

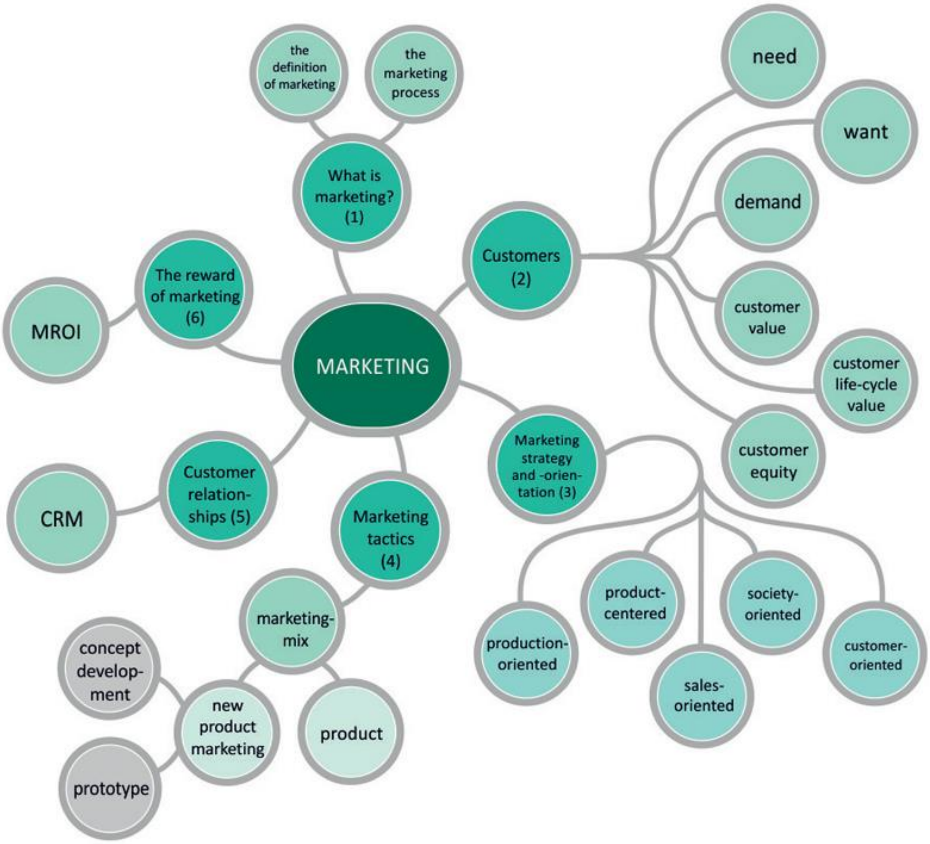
9. CHANGE MANAGEMENT (A. NOVOTNY)

9.1 OBJECTIVES AND COMPETENCES

Strengthening globalization, accelerated technological development, the constant change of consumers' needs and behaviour lead to a continuously changing business environment. One of the most important market competencies of companies, businesses, governmental and non-profit organisations is how quickly and effectively they can adapt to the changes of the environment. Most organisations, especially the big ones often resist changes, their structure, culture, management and their deep-rooted routines adjust themselves to the changed needs of the marketing environment only slowly and often too late. Due to the accelerated technological development, now a change affects a company mostly from the outside, and it does not appear as an internal want.

Organisations adapting quickly to the environment obtain competitive advantage on the market while those who follow the changes only later can suffer severe loss of sales. However, it is common not only for companies but also for certain projects that the market, legal and other conditions change, and the activities or their implementation must be changed. According to surveys, effective company management practices increase the probability of the project's success by six times. Conscious change management enables companies to shape their budget to according to the original resource-use planning, and to achieve the results as expected. The change mostly affects the whole company, ranging from the top management to the staff at the lowest level, and thus, in order to be successful, the whole organisation has to understand and learn the new business strategy and the new organisational activities.

9.2 COURCE MATERIAL



39. ábra: Concept map

9.2.1 Organisational change

The changes affecting the organisation can be of the first and second degree. The first (morphostatic) degree change is a more common phenomenon, it happens within an organisation, affects a small part, unit of it. The second degree (morphogenetic) change affects the whole company and it refers to the change of the whole system. Change management is a special field dealing mostly with morphogenetic changes. Change management most often affects the whole business strategy and business model, including the information technology system, the operations (service) procedure and the marketing activity, etc.

Organisational changes can affect both the soft and hard side of the organisation. Change management deals with the soft i.e. people side of organisations, which is often the greatest challenge for the organisational change. Let us think of the fact that it is easier to install a new production line than to teach people how to use it, or the principles and practice of lean management. It is also easier to install a new marketing software than to teach customer-oriented way of thinking to the selling staff of a store. Consequently, we can say that the soft side is the hardest part of changes.

Change management is the sum total of processes, tools and techniques, which the people side of organisational changes can be dealt with so that the organisation would achieve the business results aimed at. In more concrete terms, change management helps employees to accept, build in and make use of the change in their everday work.

There can be several reasons for the necessity of organisational change and use of an effective change management. It is important to point out that individuals also must accept the change, what is more it is individuals who must change first of all. A successful organisational change can happen only by the conviction and commitment of the individuals. Moreover, we can say that it is not the organisations that change, but it is the people forming the organisation that change. A successful organisational change is the sum total of successful individual changes.

A severe price can be paid by the company that does not lay enough emphasis on change management, and does not pay enough attention to the people side of the change. The main problem is if the organisation's management is reluctant to devote time, money and resources to the conscious management of change since, as a result, it can suffer more severe losses later if the change ends in failure, and the company goes on the way that proved to be unsuccessful earlier. It we don't treat the human side of change consciously, and don't allocate resources to facilitate the change, our business partners and our consumers will feel the uncertainty of our organisation, the fall in work morale, which can also cause tangible financial losses. The worst thing that can happen to the organisation is an unsuccessful change or a change going in the wrong direction. Therefore, we shouldn't be reluctant to allocate the necessary resources for change management.

- . According to the **ADKAR** model, the point of effective change management is to understand how people percieve change. For a change it is important that (1) the employeees should understand the necessity of change, (2) they should know how and in what they should change, (3) they should be able to change (acquire the necessary behaviour), and (4) they should support the sustainment of change.
- Originally, the ADKAR model tries to find the answer to the question of what impact change management activities have on organisational changes. The acronym ADKAR comes from the initials of five English words for five observational aspects, which are awareness, desire, knowledge, ability and reinforcement. *Awareness* refers to recognising the necessity of change, *desire* refers to our commitment to change, *knowledge* refers to having the knowledge necessary for change, *ability* refers to the implementation of change while *reinforcement* refers to sustaining the achieved goals by change.

9.2.2 Lewin's theory

The roots of the field go back to the middle of the 20th century, to Kurt Lewin, who is often recognized as the father of modern social-psychology. Lewin developed the scientific approach of change management. In the years following World War II, Lewin published two studies which give practical guides to those who would like to change the behaviour of organisations. He formulated the following principles related to the change of behaviour:

(1) As people's behaviour can be derived from the individual's environment in addition to the individual's psychology, change in individuals' behaviour can be achieved in the long run only by changing their environment.

(2) In order to achieve change in the behaviour of an individual or organisation, an imbalance must be created in the current state of the organisation.

In Lewin's model experience (*nurture*) and the individual (*nature*) shape each other, i.e. there is interdependence between the two variables. Consequently, behaviour is a function of the person and his/her environment: $B = f(P, E)$. A cheering speech by a leader is not enough in itself for the behaviour of individuals to change as the unchanged environment will go on sustaining the positive tendencies of previous behavioural norms. What is more, employees won't change their behaviour even if they hear bad news as they solve the problem by taking no notice of negative information. Therefore, in order to change, they will have to be made to experience the negative effects of their current behaviour.

The significance of Lewin's model (1975) (unfreeze, change, refreeze) is that the author points out the importance of the so called *unfreezing* phase preceding the change. Unfreezing means that the members of an organisation must question the creditability of old, routine-like organisational features, or otherwise change is not possible. It is not easy to undermine the *status quo,* and change the current organisational norms and attitudes. Change management has to face a serious resistance in it. However, only after unfreezing is there a chance to move from the current state into the target state, which is followed by a third phase, refreezing the target state.

- Lewin created the expression *group dynamics* as well. Group dynamics describes dow groups and individuals respond to changing circumstances. The field has opened the way for the development of knowledge related to such questions as "How are groups formed, how do they operate and change? How do groups enter into relations with other groups and individuals?" Lewin pointed out that the behaviour of a group is not merely the sum total of the behaviour of the individuals: the whole is always more than the sum total of the parts. When a group is formed, becomes a unified system, it comprises such qualities which are difficult to understand by assessing the individuals forming the group one by one.

9.2.3 The key concepts of organisational change

The foundations of an organisation's operation and its renewal ability are *strategy, culture* and *management*. Strategy determines the goals of an organisation, and organisational culture determines whether the organisation will be able to implement its business goals. The role of management is important because managers are primarily the ones who shape both strategy and culture. If management builds culture consciously, it can considerably facilitate the organisation's ability to accept necessary changes. Whether it is planned or formed spontaneously, culture is present, and influences organisational and individual responses to changes. Changing culture is very often part of transforming an organisation, especially when bad routines or anti-change values became the foundations of operation before.

Business strategy and business model

Successful organisations cannot afford to remain static. The change within the organisation must be started by the management. Change often means creating a new strategy, which ensures the success of the project or organisation in a dynamic market environment. The strategic renewal of the company often involves developing and introducing a new business model. The **business model** and **company strategy** are closely related: the business model describes an important aspect of strategy in an abstract way. While strategy is owned by the company, the same business model can be applied by several companies at the same time.

A business model is a part of business strategy. The business model describes how the company creates and transmits value for customers, and how it takes over value (reward) from them in return. The business model formulates the business logic of the given company, decribes the value to be offered to customers, the technology applied, the method of work organisation and the partner network of the firm, etc. It contains the value offers for customers (product, price, contact possibilities, image-benefit), the profit formula (expenses structure, income model, return rate, the key processes (K+F, production, HR, marketing, IT), as well as the most important resources (brand, people, technology, partners, distribution channels). By the innovation of their business model the following firms got market leading role: McDonald's, Wal-Mart, Amazon, Netflix, Starbucks, Intel, eBay and FedEx, etc.

The following table shows some examples for the changes of strategy and business model, respectively:

1.	Instead of product manufacturing (hardware), the company lays the emphasis on offering services (software, support).
2.	A company offers software and other media contents not through physical information carriers, but through online downloading.
3.	A company enters the international market from the domestic market, organises the supply chain in international relations.
4.	A company buys up the members of the distribution channel.
5.	A school offers its trainings not only in classrooms but in the form of correspondence courses.
6.	A company outsources certain activities, which were done within the company before. Another way of outsourcing is if the company buys certain services from abroad, which it purchased in inland before E.g. accountancy, law, IT, business advice and promotion, etc.)
7.	A company looks for foreign suppliers instead of domestic suppliers.

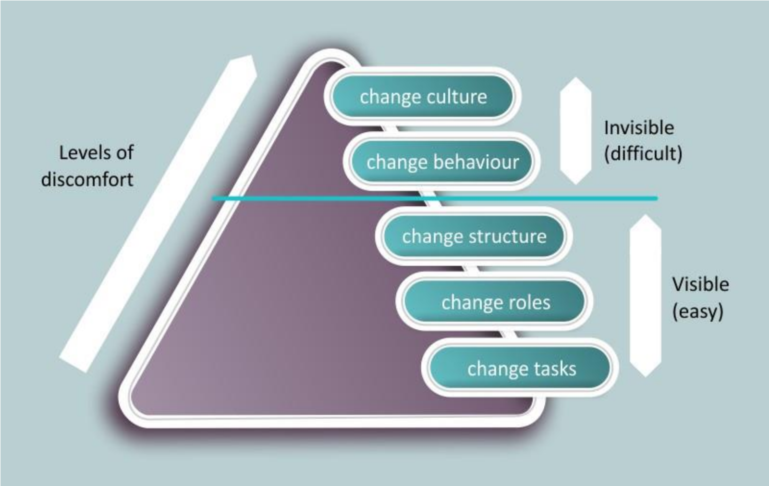
8. A company enters into a strategic alliance with other similar (vertically or horizontally related) companies.
9. A company carries out it K+F activities in several countries from now on, in order to be able to involve more professional knowledge and various points of view.

Organisational culture

As was mentioned before, change management often makes it necessary to change the organisational culture as well. (E.g. introducing customer-centred way of thinking), as the behaviour of individuals greatly depend on the norms and values acquired together. Although the change of culture is initiated by the management, it must be accepted by all employees.

Organisational culture is the sum total of values and behaviour norms which form the unique psychological character of an organisation. Organisational culture comprises the expectations, experience, philosophy and values of an organisation which keep the organisation together; and which are expressed in the self-image of the organisation. It manifest itself in such written and unwritten rules, common attitudes, beliefs and habits which are formed by time, and which are accepted by the members of the organisation.

Organisational culture influences the productivity and performance of an organisation, product quality, employees' participation in the work, accuracy, social responsibility, marketing activity and production. Culture also shows itself in how the organisation treats its employees, customers and the broader environment. Organisational culture also finds an expression in the decision-making processes in how much independence employees get in their decisions, in generating new ideas and innovations and in the company hierarchy; as well as in how committed employees are to the joint goals. Culture is different from organisation to organisation; and it is the organisational factor which is perhaps the most difficult to be changed (see figure).



40. ábra: Change pyramid (Burtonshaw & Gunn, 2008)

Organisation development

Change management often forms a part of a comprehensive organisation development plan. **Organizational Development** is a conscious activity encompassing the whole organisation, which makes is possible for the organisation to operate effectively; and to achieve its strategic goals. Organisation development enables a company to handle change, which may require to change beliefs, attitudes and values (organisational culture); and to rethink organisational structure so that the organisation can acquire new technologies and the changes in the business model better.

Some people think that organisation development is not only about people, but about the processes, systems and structures of the company, i.e. it is not only about staff development but the development of the whole organisation as well.

Organisation development (OD) is tool for increasing organisational efficiency, which turns to behaviour- and society sciences for help in order to facilitate organisational change. Instead of a symptomatic treatment, it focuses on realising lasting organisational changes, solving real problems; and enhancing the learning abilities and self-development of the organisation.

In organisational development the whole organisation must be scrutinised. Such an organisational atmosphere must be created which makes it possible for all employees to express their thoughts and ideas openly. It is worth developing a communication system which mediates the results of the development from bottom up to the top management.

9.2.4 The problems of organisational change

Resistance towards organisational changes is not uncommon, especially in big organisations. Resistance means that the employees want to keep the current *status-quo*, the current position in the organisation, openly or hidden. If an employee can satisfy his/her needs according to the present state, he/she will **resist changes**, what is more he/she will consider them as a negative event or threat for himself/herself.

Employees generally see well that changes **mean both costs and benefits,** but they often don't believe that the benefits exceed the costs. It is also possible that although employees receive the change positively, they don't believe that the managers of the company will be able to implement it out properly. If the individuals believe in the importance of changes, they do not necessarily believe that the changes will also take place successfully. Therefore it is extremely **important to involve employees** in the changes so that they can take part in decisions related to their work. It the management "directs" the change only from the top, it can encounter severe resistance. In contrast, change based on participation can win many supporters in implementing changes.

As human beings naturally resist changes, change management has many pitfalls. One pitfall is if the organisation starts the **change by rewriting complex systems** (E.g. new organisational structure) as employees often don't understand the reason for that, they cannot have a good grip of the situation from the bottom; and they resist the initiative coming from the top like a reflex. Another mistake is if the organisation wants to achieve the new goals primarily by **changing human resources** (taking on new employees, dismissing old ones) because structures don't change in this case. Thus the new employees won't achieve – much – better results in the bad old work processes. It is also a common mistake if the top management wants to **change the structures autonomously** without understanding the reality of the employees' every day work and problems.

9.2.5 Criteria of successful change management

As was mentioned before, **company culture** is the key of organisational change. According to the survey of Katzenbach Centre, the majority of company managers consider organisational culture to be the most important element of change, more important than strategy or business model – as it stands in a study by Aguirre and Alpern (2014). In the authors' view, if the management does not deal with the elements of organisational culture thoroughly during the change, it is very likely to be doomed to failure as the key of the success of change is to **conquer cultural resistance**. Instead of trying to eliminate the current culture completely, a clever management seeks to reveal the elements of the current culture which tend to change, and draws energy from them. We must make most of the current culture while creating the new culture.

Although organisational change is not possible without engaging employees, it must be **initiated by managers** with the support of the top management or proprietors. The best is if the leaders of the company plan the changes needed for the new strategy of the organisation thinking together, of course by engaging all employees at the lower levels. As **the organisation leaders at different levels** are aware of the faults, and problems of the particular units and functions of the organisation, and the expected responses of consumers, to win employees can help a lot in the transition.

To win the support of the **employees** at the lower levels for change can help a lot while their resistance can make it almost impossible to implement change. Change management will be successful if as many employees as possible (not as few as possible) are engaged in it. Consequently, we should spare no effort or money to do a wide range of actions. Although the process won't be quick, change can be implemented effectively only if it is done slowly and carefully.

- It is not only managers who can initiate change. It also often happens that it is employees who demand change from the management, e.g. by the help of the trade unions or by strike. There are also changes which are welcomed by both sides, and there are examples for cases when external circumstances force modifications, which neither party would be willing to do by itself.

Besides rational arguments, it is also worth appealing to emotions. To reduce costs, to increase efficiency and higher quality, and to focus on customers, etc. sound as logical goals, and most workers will understand why they are important. However, if we cannot **arouse emotions** in people, we won't even achieve that they will be enthusiastic about the goals.

Setting a good example in our actions can be stimulating. Leaders have to integrate routines into their everyday activities which are novel and serve change, among others that they set a good example with their personal activity. Similarly, **continuous communication** is also important. It is not enough if leaders call employees attention to change.

It must be reinforced again and again. Otherwise the new stimulus won't achieve the necessary threshold level.

In addition to formal managers, it is also worth seeking and engaging **opinion leaders** of the community in communicating change. We must win the support of people who the members of the community look up to for some reason. **Informal solutions** can also help a lot in achieving success: besides effective production development and quality-control, "friendly" memos can also be used, such as a new slogan, a new face or website. Many success-hungry managers don't pay enough attention

Finally, during transition it is important to **measure the results continuously** and to validate it before entering the next stage. Many success-hungry managers don' pay enough attention to assessing part results systematically to examine which of the planned changes work well and which don't. The lack of following employees' and customers' feedback can create the false impression that the changes have been implemented successfully.

9.3 SUMMARY, QUESTIONS

9.3.1 Summary

A conscious change management creates competitive advantage for companies as they can change quickly and effectively by it, in order to satisfy market needs better and more effectively. Change management deals with the people (soft) side of organisational changes and appears at every level of the organisation: at the highest, middle and lowest level. If change management is done well, people will feel that they have also been able to contribute to the organisation, and by this they will be work more committedly towards the new common goals.

Company managers shouldn't be reluctant to provide resources to change management as there is no quick and cheap change. Moreover, a badly implemented change can deteriorate the performance and image of a company in the long run. Lewin was the first to take a scientific approach to change management, which points out that frozen organisational values must be unfrozen before change, and following change the ideal change must be refrozen.

The key concepts of change management are *strategy, culture and management.* Strategy sets the goal for the organisation; organisational culture determines whether the organisation will be able to implement the change, and to achieve its business goals by it. The management creates organisational strategy and culture, and thus change management is primarily the management's responsibility but it can also make use of the help of professional change managers as well during implementation.

Several mistakes can be made in the implementation of changes, the biggest of which is if workers and employees are not engaged in changes affecting their own work. Changes must be communicated consequently, and both formal and informal means must be used in transmitting them (e.g. leaders' setting an example, company opinion leaders, web site, etc.) Finally, results achieved during change management must be measured so that it will turn out whether the necessary steps have brought any result, or whether further modifications and repeated steps will be needed.

9.3.2 Questions for self-assessment

1. What is the difference between morphostatic and morphogenetic changes?
2. Give the definition of change management.
3. What is it important to provide sufficient resources for change management?
4. What does the behaviour of an individual depend on in Lewin's approach and how can it be changed?
5. What are strategy, culture and management important in the operation and renewal ability of organisations?
6. What is the difference between business strategy and business model? Give some examples for them, too.
7. What is organisational culture and why is it difficult to change?
8. What is organisational development (OD) for?
9. What problems can arise in organisational change management?
10. What are the criteria of successful change management?

9.3.3 Practice tests

1. What is the process of change management in Lewin's model like?

a) unfreezing, change, refreezing
b) freezing, change, unfreezing
c) warming up, change, freezing
d) warming up, change, unfreezing

2. The ADKAR model helps change managers to be able to focus on the particular aspects and results of change one by one. (T/F)

3. In Lewin's model the behaviour of the individual (B) can be described by the following equation: $B = P+E$, where P refers to the environment, E refers to the personality. (T/F)
4. Group dynamics describes how groups and individuals respond to changing circumstances. (T/F)
5. Strategy describes one certain aspect of business model. (T/F)
6. Organisational culture refers to the behaviour of particular workers. (T/F)
7. Organisational development concentrates on particular departments. (T/F)
8. Change management is mostly the responsibility of the leaders of the organisation. (T/F)
9. It often happens that workers accept organisational changes positively; still they do not believe in their success. (T/F)
10. It is a common mistake that the leaders of an organisation want change very quickly, but they don't allocate sufficient resources for the activities of change management. (T/F)

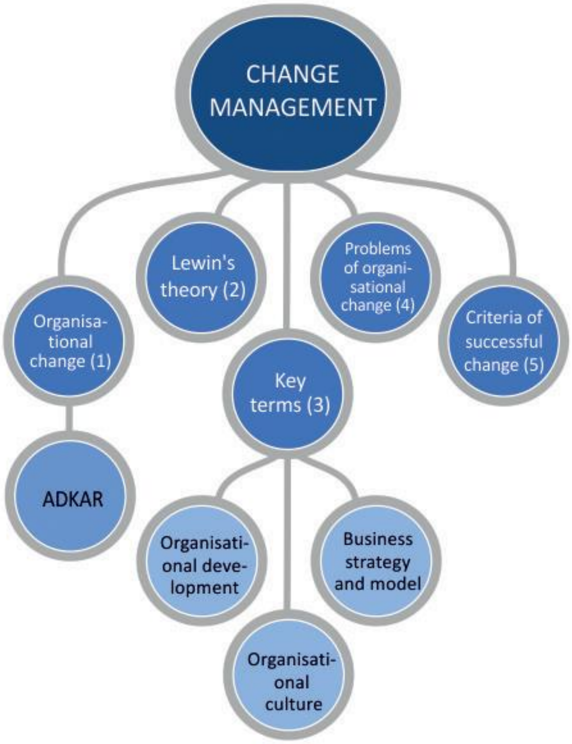
10. STRATEGY EVALUATION AND CONTROL (A. NOVOTNY)

10.1 OBJECTIVES AND COMPETENCES

Strategy is a comprehensive plan aimed at achieving long-term goals. Strategy planning and strategy control are to be done not only by large companies, but by small and middle-sized companies as well – provided they want to remain competitive on the market. Evaluating strategy continuously is just as important as planning it since only continuous control makes it possible for us to change our plan according to the changed market environment and our changing internal resources, and thus to achieve our planned results. The most important part of evaluating the plan is to compare the tasks, goals and key areas formulated before with our achieved results. For evaluation we must use indicators which also show quality, effectiveness and efficiency.

In strategy evaluation special attention must be paid to the performance criteria, on the basis of which we want to evaluate the performance achieved by the organisation. During control, it is worth choosing only factors which, on the one hand, can be measured, and on the other hand, are directly related to performance. Merely quantity indicators are not suitable by themselves, and therefore it is worth supplementing them with quality indicators. In this lesson first we will present strategic management, and then the steps of strategy control. Furthermore, we will discuss the aspects of strategy evaluation, and the interpretation of audit and benchmarking activities and their relations. At the end of the lesson we will outline one of the most popular strategy-evaluation methods, the Balanced Scorecard (BSC). BSC is not only a strategic tool but a complex management system as well, which enables a company to make its mission and strategy unambiguous, and to determine the concrete steps needed to achieve them.

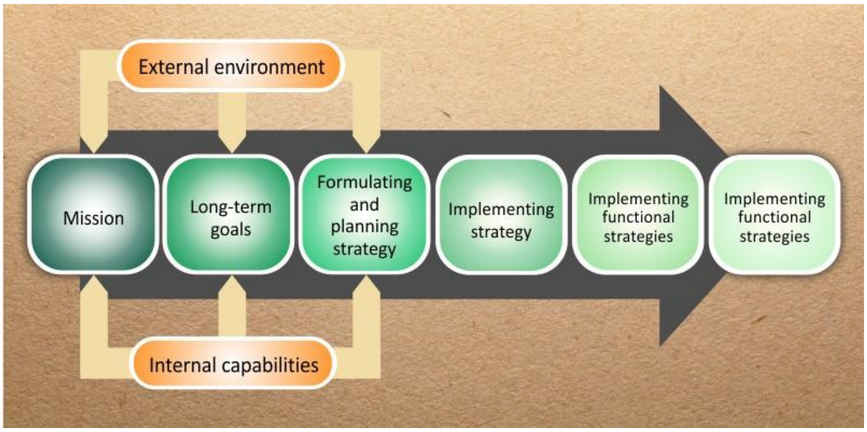
10.2 COURSE MATERIAL



41. ábra: Concept map

10.2.1 The process of strategy-management

The figure below shows the process of strategy management. Strategy management is derived from company mission and goals; and it is closed with the measurement of company performance. The most important external forces which influence creating strategy are globalization and international market trends, the development of information and communication technologies, and the issue of taking social responsibility. The latter involves aspects of people and environment and business ethics. Internal capabilities refer to intellectual, infrastructural, technological and financial resources.



42. ábra: The process of strategic management

If we want to divide strategy-management into three stages, we must point out planning, implementing and evaluating as main steps. In this lesson we will deal with evaluation. For evaluating strategy, it is important to know the foundations, i.e. the mission and long-term goals of a company. While doing an evaluation, we compare the expected results with the actual results, and if we see a difference, we take the necessary measures to correct it. Strategy-evaluation highlights the efficiency and effectiveness of the plans and organisation with respect to achieving the set goals.

- **Efficiency is the rate of useful expenses on all expenses. We are efficient if we achieved a good result by using relatively little time, money or energy for the intended purpose. The formula of efficiency can be results/invested resources, output/input, or in term of finances incomes/expenses.**

- **Effectiveness expresses whether a given activity or expense has a result or effect, whether the expected change happens, which we made efforts for.**

The main difficulty is that strategy must be evaluated in a dynamically changing social, political and technological environment. Consequently, evaluating strategy is the last, but an extremely important step of strategic management as it provides inputs for creating a new strategy, developing the process of strategic management, rewarding workers and for judging the validity of strategic choice.

10.2.2 The steps of strategy-evaluation

The process of strategy-evaluation has the following four steps:

Determining performance criteria

The organisation has to decide what performance criteria to set and how to measure and express them. For identifying criteria, we must know the primary conditions of doing the task. We can use both quantitative and qualitative criteria. A quantitative criterion can be, for example, the size of profit or turnover, the return on a share, the return on investment and fluctuation of workers. Qualitative criteria comprise subjective factors, such as new skills and competences developed, e.g. organisational flexibility, customer-centeredness, or problem solving skills.

Measurement of performance

Performance expectation is determined by the selected criteria. If these criteria are defined properly (in a measurable way), it won't be difficult to measure the performance of the organisation. Nevertheless, there will be aspects which won't be easy to be measured and evaluated even so, either (e.g. managers' contribution to the performance of the firm).

Analysing variances

There may be variances between expectation and performance. A deviation in the positive direction means that the company has performed better than expected. However, a deviation in the negative direction can give reasons to worry. The primary task of management is to analyse the size and importance of the deviation. It is important to decide the degree of tolerance limits between which the variance between actual and standard performance may be accepted. In the case of negative deviation the management must take a corrective action to overcome it.

Taking corrective actions

If performance falls short of goals, the management must evaluate the causes and size of underperformance. It is possible that the intellectual, financial and infrastructural resources are not suitable for achieving the performance designated in the expectations. In this case, the performance-indicators must be changed. Changing strategy is a drastic step, but it is also a possibility; at this time we must go back to the beginning of the planning process.

- A company **must be prepared** for the possibilities that the result won't match the expected goals, or they will exceed them. There can be **external and internal reason** for that. For example, what should happen if sales do not meet expectations, how should we keep profit in this case? What should we do if demand exceeds expectations, how should we bridge the possible shortage? What should we do if technological development and the quick response of our competitors make our products obsolete earlier?, etc. Consequently, the organisation must also be prepared for more positive and more negative events than expected, must analyse their possible effects, and prepare continency plans to overcome problems. It is important to develop a control system that can indicate possible problems on time, and not only when it is already rather difficult to take correction actions.

Company strategy can be interpreted **in the relation of market competition, market position**. When evaluating strategy, we must also give answers to such primary questions as: How did competitors respond to our strategy? How did their strategy change in the meantime? Do they have any strengths and weaknesses? If they made changes, why did they change their strategy? It is worth assessing how satisfied competitors are with their current market position, to what extent they feel that our strategy is attacking, and how far we can go without our competitors taking revenge. Perhaps it should be considered how we could cooperate with them.

One further aspect of evaluation can be to find out if strategy is built on the organisation's SWOT analysis. How did our strengths and weaknesses change in the last period of time? Did new opportunities and threats arise? To what extent was strategy built on our strengths and opportunities? How did we manage to ward off market threats and eliminate our organisational weaknesses? How much does strategy strengthen our social goals?

Criteria of strategy-evaluation

During strategy evaluation external and internal aspects must be taken into consideration. Rumelt (1993), an expert of business strategies suggests the following criteria to analyse organisational strategies. "Consonance" and "advantage" mean **external,** "consistency" and "feasibility" mean **internal** evaluation criteria.

Consistency

Strategy should not seek to realize contradictory goals. If we experience clashes between different units within the organisation, it is very likely that the strategy means to realize inconsistent goals. The lack of consistency is obvious mainly if contradictions were created not because of the personal conflicts of employees and managers, but the conflicts arose due to contradictory tasks. If it is not possible to create a “win-win” situation between particular departments, there are severe problems with the strategy. Similarly, if the lower levels turn to higher level leaders with problems on a continuous basis, it is very likely that the strategy is inconsistent.

Feasibility

The final test of every strategy is whether it can be implemented in the current situation of the organisation, relying on the physical, intellectual and financial resources available. In general, in involving financial resources, organisations tend to be more flexible and innovative than in that of intellectual (human, structural and relational) resources. Therefore in evaluation special attention must be paid to how individual and organisational competences influenced strategy implementation.

Consonance

According to the criterion of consonance while evaluation strategy we must examine several tendencies and their impacts on each other as well. It is not enough to analyse market trends, we must see the impact of trends on each other, their crossings as well. For example, that university research is getting more and more market-centered is due to scientific, political and economic wants and processes, which met in time to trigger changes in the mission and strategy of higher education institutions.

Advantage

Strategy must ensure some kind of a competitive advantage for the company. Companies can obtain competitive advantage from some resource, capability or a market position. A strong market position means that the company focuses its resources and capabilities on a well-defined segment, which makes it difficult for competitors to undermine it. For example, big companies try to make the most of advantages due to their size while smaller companies have to find other resources and capabilities to hold their ground in the market competition. Thus, strategy must always be evaluated from the point of view of what position the organisation has in the market as it is possible that a given strategy in that given position is more valuable and effective than in the case of organisations with a different market position.

- An important aspect of strategy evaluation is that is should be **commercially viable**. Gathering too much information and too meticulous control can be just as harmful as superficial evaluation. What is even more important than the quantity of data is that such information should be gathered which are closely related to the goals of the organisation. Furthermore, control should take place on time and it should reflect reality. Mutual trust must be developed between employees and strategists with respect to control, and employees must be made to understand that providing real and honest information is not only for the company but for their own future is also crucial.

Audit, benchmarking, monitoring

While defining performance criteria, the company can use both internal and external measures. It can compare its performance with its earlier self, that of main competitors or industrial average. The terms **benchmark, audit** and **monitoring** are often used in analysing strategy and a company's performance although the difference between them is not made clear in every case.

- **Audit is primarily a quality improvement process in which organisational performance is evaluated relative to a pre-determined criterion or performance standard (comprehensive performance indicator).**

The aim of strategic audit is for the organisation to evaluate the effectiveness of its strategy in achieving its goals. Strategic audit is a process during which the management regularly controls whether the company is going towards its goals. If it has achieved the goals, new measures will be created, and the process starts again. If it didn't manage to achieve the goals, it is necessary to examine the strategy and its implementation, and to take corrective actions. Audit is about more than just examining financial performance. It comprises environmental, social and other areas as well. In simple terms, the point is to compare the pre-determined standards with the performance of different areas of the organisation.

- **Audit** is the systematic, independent and documented process of gathering evidence and evaluating it objectively. It's aim is to determine how well the audit criteria were met. **Audit criteria** include policies, procedures and requirements, i.e. every policy, patent, rule, manual, etc. which are used as a base of comparison for what we examine to find out whether they are met. **Audit evidence** includes records, factual statements, and other verifiable information that is related to the audit criteria being used. Audit evidence can be documents, notes, data bases, but oral information and what was experienced during a tour of inspection as well. Audit evidence justifies objectively that the criteria are met. An audit seeks not to find errors but it points out the critial points of operation, and helps leadership to take corrective actions. (Berényi, 2011)

- In the process of benchmarking the various aspects of a organisation's processes are compared with the best practice, usually within its own sector.

Thus, benchmarking is a comparative technique, which shows where the organisation can develop, and how it should adopt the best practice. If the company's market performance does not approach that of the best competitors', strategy will probably have to be changed. In auditing we compare our performance with our own expectations while in the process of benchmarking we compare our results with the performance of the best firms in the industry, or the performance of a firm that should be followed from a certain view point.

- **By monitoring the management gets feedback about whether its decisions guide the company towards the set goals, as well as what progress the company has made towards the goals. On the basis of monitoring leaders can modify their decisions.**

The importance of monitoring has already been touched upon in chapter 6.2.2. If it is done well, monitoring examines not only whether we are doing things that we have planned but also whether we have got closer to the organisation's goals. Consequently, it examines not only the precision of implementation but its results as well. The main difference between audit and monitoring is that the latter is the managers' responsibility and is not done by external experts. The function of monitoring is to give continuous and regular feedback to the top management, i.e. decision support. In contrast, auditing is an examination aimed at revealing whether an organisation is doing its job well, for example, whether it uses its resources effectively or complies with legal requirements. Monitoring is mostly done continuously while audit is usually carried out by companies at the end of a project.

10.2.3 Balanced Scorecard

The **balanced scorecard** (**BSC**) is a strategy performance evaluation tool that can be used by managers to keep track of the execution of activities by the staff within their control and to monitor the consequences arising from these actions. The method combines short-term and long-term viewpoint, financial and non-financial aspects as well as internal and external factors. In its view, financial measures are not enough by themselves to evaluate organisations as they present only the past, and thus they are not suitable for giving a comprehensive, future-oriented evaluation of the information society's companies. Another advantage of BSC is that it examines a relatively small number of metrics. It compares the measures with one target value, which is summarised in one single short report. The report does not replace a company's financial reports, but it provides important information for its readers.

The first version of BSC was for profit-oriented companies, and besides financial metrics, it also took into account customers, internal business processes as well as learning and growth. Modern BSC approaches can be utilized for several different organisations (e.g. non-profit ones) and are easier to use.

- BSC is a strategy planning and strategy management tool (not only controlling), which was devised Robert Kaplan and David Norton. Although the terminology of the method was coined in the 1990s, the origins of performance management represented by it goes back to the pioneering work of General Electric on performance measurement reporting in the 1950s and the work of French process engineers in the early part of the 20th century. According to certain surveys, more than a half of large American firms use BSC today, and companies use performance examination approaches similar to BSC all over the world. BSC is the most commonly used management tool in the world, and according to Harvard Business Review, BSC is one of the most effective management tools of the last 75 year. [57]

BSC is a management system which makes it possible for organisations to see their mission, vision and strategy clearly, as well as to be able to transpose them into action. It gives feedback about a company's internal business processes, and about its external business results, in order to increase the company' strategic performance.

[57] BSC Institute, http://balancedscorecard.org/Resources/About-the-Balanced-Scorecard

43. ábra: The structure of BSC (Kaplan & Norton, 1996, 76.)

The balanced scorecard suggests that we view the organization from four perspectives, and to develop metrics, collect data and analyse it relative to each of these perspectives:

Knowledge and innovation

This dimension comprises attitudes related to employees' training and organisational culture. In knowledge-based organisations employees mean the most important resource, and it is especially important for them to learn continuously, develop and master innovative and creative thinking. Learning is more than company training. It implies company mentors and tutors, as well as the whole organisation's learning ability.

Internal business process

The examination of internal business processes makes it possible for company managers to get an overview about how much its products and services meet customers' expectations. The metrics related to organisational processes can be best designed by company managers who know these processes well, and are not something that can be developed by outside consultants.

Customer perspective

When examining company performance, we must pay especially great attention to customers' satisfaction. Poor performance from this perspective is a leading indicator of future decline, even though the current financial metrics do not indicate trouble.

- Customers' satisfaction means an important performance metric for companies. For example, the science of marketing deals with customers' needs, and providing the most suitable offer for them. The modern customer relationship management –systems (CRM) make it possible to give a detailed analysis of interactions with customers, create possibilities for product links, to sell more and more expensive products, as well as they call our attention to unsatisfied customers on time. They also make it possible to measure customer lifetime value (CLV).

Financial perspective

We must not disregard traditional financial metrics, either although we shouldn't attribute to much role to them. The presentation of primary financial results can be supplemented by cost-benefit analysis or risk assessment.

Summarising, BSC is not only a strategic management tool but also an organisational performance evaluation "dashboard". It is similar to the instruments on the dashboard of a car, which show speed, revolutions per minute, fuel consumption, distance and direction. When applying BSC, we must develop metrics for all strategic goals, and action plans which ensure to achieve them.

10.3 SUMMARY QUESTIONS

10.3.1 Summary

In this chapter first we presented the process of strategic management. We pointed out that strategy evaluation and control is the final, but perhaps the most important step of strategy management. The evaluation of strategic results helps an organisation to improve the efficiency and effectiveness of business processes and to achieve its goals.

Strategy control has four steps: (1) defining performance criteria, (2) measuring performance, (3) analysing deviations and (4) taking corrective actions. The most important step is choosing the correct performance criteria as well as taking proper corrective actions.

Company strategy must be examined not only as compared against performance metrics, but also against the performance of competitors. Furthermore, a good strategy relies on a SWOT analysis, more exactly on the strengths and opportunities of the company, and decreases its weaknesses, and possibly averts or wards off external threats. In the lesson we described the strategy evaluation criteria proposed by Rumelt, namely consistency, feasibility, consonance and competitive advantage.

Audit and benchmarking are two concepts which are often used when evaluating company performance and strategy. In the process of auditing the organisation compares its performance against its own expectations, in that of benchmarking the base of comparison is the best performance in the industry or a performance that should be followed from a certain aspect.

At the end of the lesson we discussed the BSC strategy evaluation method, the main advantage of which is that it examines not only the financial performance but the organisation's learning ability, the impact and efficiency of business processes, and the degree of customers' satisfaction as well. The last one is perhaps the most important metric in strategy evaluation as it is difficult to imagine that a company can survive with unsatisfied customers in the long run, especially if it is not in a monopoly position.

10.3.2 Question for self-assessment

1. Name the steps of the strategic management process.
2. What external and internal factors is strategic management influenced by?
3. What is the difference between efficiency and effectiveness in connection with companies' performance?
4. What are the steps of strategy evaluation?
5. What do we mean by saying that company performance can be interpreted only in its relation to market position?
6. How is the SWOT-analysis related to strategy evaluation?
7. What do consistency and feasibility mean in Rumelt's strategy evaluation model?
8. What do consonance and competitive advantage mean in Rumelt's model?
9. What is the difference between audit, benchmarking and monitoring?

10. What is the BSC is a popular strategy-evaluation model. What company dimensions does the BSC examine?

10.3.3 Practice tests

1. You can find below the external forces that influence organisations in their strategic management. Which one doesn't belong to them?
   a) globalization and international market trends
   b) taking societal responsibility
   c) oil price booms
   d) the development of information and communication technologies
2. Which of the orders below reflects the correct order of the process of strategic management?
   a) goals, mission, planning and implementation of strategy, control
   b) mission, planning and implementation of strategy, goals, control
   c) control, mission, goals, planning and implementation of strategy
   d) mission, goals, planning and implementation of strategy, control
3. Which of the orders below reflects the correct process of strategy evaluation?
   a) determining performance criteria, measurement of performance, analysing variances, taking corrective actions
   b) measurement of performance, determining performance criteria, analysing variances, taking corrective actions
   c) taking corrective actions, determining performance criteria, measurement of performance criteria, analysing variances
   d) determining performance criteria, analysing variances, taking corrective actions, measurement of performance
4. Which of the following does consistency refer to in Rumelt's model?
   a) Strategy must not present mutually inconsistent goals.
   b) Whether strategy can be realised in the correct position of the company, relying on the available physical, intellectual and financial resources.
   c) While evaluating strategy we must examine several tendencies and their impact on each other as well.
   d) Strategy must ensure some kind of competitive advantage for the firm.

5. What do we mean by audit criteria?
   a) Notes that can be controlled, factual statements or other information.
   b) all policies, procedures and requirements, which are used as a base of comparison for what we examine to find out whether they are met.
   c) Benchmarking requirements.
   d) One perspective of the BSC.
6. In the process of benchmarking the different aspects of the organisation's processes are compared with the best practice. (True/False)
7. The BSC lays main emphasis on financial processes. (True/False)
8. Strategy must be built on the company's SWOT-analysis. (True/False)
9. The performance criteria used for strategy evaluation must be numerical, i.e. quantitative in each case. (True/False)
10. The three main steps of strategic management are analysing, planning and implementation. (True/False)

11. BUSINESS PERFORMANCE (A. NOVOTNY)

11.1 OBJECTIVES AND COMPETENCES

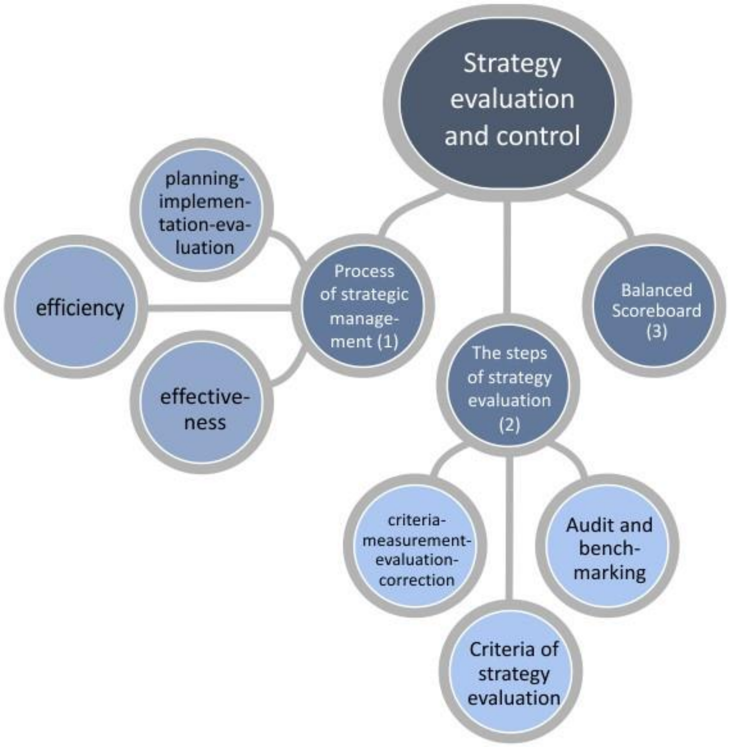
Organisations' performance is closely related to the success of strategy applied, and therefore analyses examining the results of strategy are also closely related to a company's overall performance. Analyses evaluating strategy success are a part of a company's performance evaluation, which is the reason why we presented it in the previous lesson. In this lesson we will describe indicators and performance criteria which examine company performance from several different aspects. Company performance can be examined from the side of finances (e.g. profit, return), from the aspect of marketing (e.g. market performance of a product or service, market share, sales), from the viewpoint of operations (e.g. efficiency, outputs) or simply from the side of stakeholders (e.g. value of shares).

Company performance is examined, measured and analysed not only by top management who plans strategy, but by managers at lower levels, financial experts, operations managers, and even by legal experts as well. For example, the BSC method introduced in the previous lesson is a company performance measurement tool with several dimensions, which lays emphasis not on financial performance. In this lesson we will present both simpler and more complex methods than BSC. One of our main classification principles is whether the given tool focuses on company performance or rather on its value. Value is the result of much more complex processes than merely current performance.

The other dimension on which we will examine company performance is how complex the performance measurement tool is. There are evaluations built on one single measure (e.g. efficiency ratio indicators, price-earnings ratio indicators) and there are also evaluation systems applying several different aspects, qualitative and quantitative approaches at the same time.

Our aim is to develop analytical thinking. Company's performance will be divided into functional units, departments, and their relations to each other will also be examined. Eventually, it will turn out that the whole is always more than the sum total of the parts, which will be shown by value based metrics. A company's market value does not necessarily reflect the company's financial, operations and marketing performance, but subjective factors also play a role in it.

11.2 COURSE MATERIAL



44. ábra: Concept map

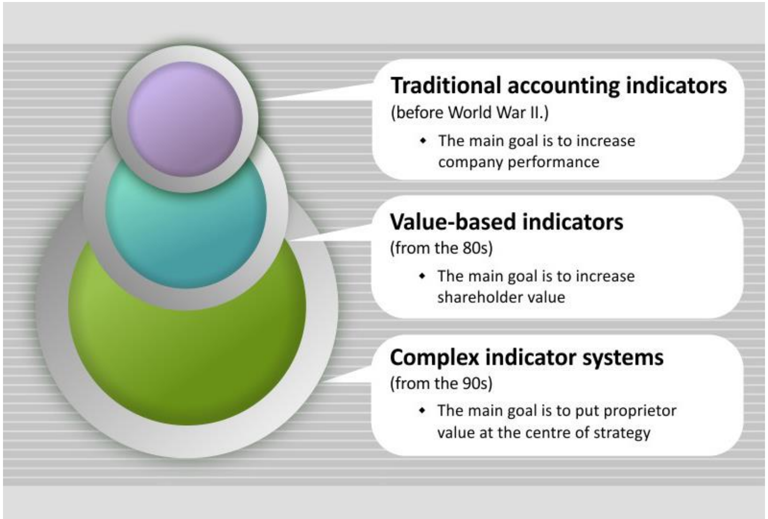
11.2.1 Organisational performance measurement

Organisations have never had so much information at their disposal to make decisions as nowadays. Larger companies collect data systematically about their business activities, the market environment, suppliers and competitors, which help them a lot to evaluate their performance and achieve strategic goals.

Managers usually examine company performance by somewhat arbitrarily chosen metrics, the so called **Key Performance Indicators**. By key indicators it can be examined whether the company is going on the right way towards its goals. Indicators try to grasp complex organisational processes in a simple way.

Key indicators can also be interpreted in such a way as when a doctor describes a patient's state by using some primary health *values (e.g. blood pressure, temperature, cholesterol level blood sugar level, etc.).*

Next we will give an overview of the most important performance indicators as well as approaches related to company performance measurement.



45. ábra: The development of company evaluation methods (Fiáth, 2008)

The earliest approaches put the company's objective (internal) value at the centre, which was based on various accounting categories, on assets elements and accountancy profit and did not take judgements of market value into consideration. Towards the end of the 20th century, the traditional accounting measures of performance were gradually replaced by **performance indicators examining the company's market value.** Attention is shifted from consumers to **company owners** and its other partners (stakeholders). The new goal was to **maximize owners' value**, what is more to put it at the centre of company strategy. Although company value seems to be expressed best by the price of shares, in the case of small or start-up companies there is much less information available than for larger ones, therefore other more targeted indicators are necessary.

Meeting customers' needs simply does not necessarily yield gains, and it results merely in income increase. In other words, market increase does not go hand in hand with value creation in each case. Therefore most companies operating today set value creation as their main goal. Value increase can primarily be achieved by economic rationalization (turnover increase, cost reduction, labour force development) or by realizing projects the return of which means the best investment possibilities for the company.

- As a supplement to figure 47 it must be mentioned that performance evaluation has a very long tradition. Most historians mean that our ancestors strived to create its possibility by inventing writing. Double-entry bookkeeping aimed partly at that was developed at the dawn of the Modern Era.

		ACCORDING TO COMPLEXITY	
		Method based on only one metric	*Complex methods of value increasing*
ACCORDING TO FOCUS	*Focusing on company performance*	Price/earnings ratio indicators (**ROI, ROE, ROA, EPS, P/E**), Efficiency indicators	**Balanced Scorecard** (BSC), Process management (BPR), Structure-based methods, Strategic management concepts, Knowledge management, Behaviour-based approaches
	Focusing on value	**EVA** and **MVA** indicators; **ROIC, CFROI**	Value-centred management

46. ábra: Approaches and indicators of company performance and value (Becker, Turner, Varsányi, & Virág, 2005)

Next we will discuss the main company performance and value indicators on the basis of the figure above. One aspect of grouping is what the **focus** of the method is, which refers to whether increasing company value or some other company performance is at the centre of the method. The other aspect is complexity, which differentiates indicators according to whether measuring value or performance is based on **one single metric** or on a **complex value increasing method**.

- It must be noted that performance indicators can be grouped in other ways as well. Accordingly, we can talk about indicators that can be expressed in terms of absolute value, ratio indicators (return on …), traditional indicators and value based indicators as well. See the following table.

	Traditional indicators	Value based indicators
Absolute numbers	operating income, net income, EBIT	EVA, MVA, Economic Profit (EP), Cash Value Added (CVA)
Return on… metrics	ROA (…Assets), ROE (…Equity), ROI (…Investment), ROS (…Sales), ROC (…Capital)	ROIC (…Invested Capital), CFROI, RONA (…Net Assets), ROCE (…Capital Employed)

47. ábra: A classification of company performance indicators (based on Friedl & Kettenring, 2009)

11.2.2 Simple performance indicators

Profitability indicators

The main advantage of **profitability ratios** or “**Return on” indicators** is that they make it possible to make comparisons between companies in the industry. It must be pointed out that it is not enough to calculate profitability by itself, but it is always worth comparing it to the equity, assets, investments and sales.

Return on equity is the main measure of the profitability of owner’s equity (shareholder value). It shows how effectively a firm generates profit in relation to the unit of shareholder’s equity.

In other words, ROE shows how well a firm uses its equity to generate income. The ROE between 15-20% can be regarded to be good. ROE is calculated as follows:

ROE = Profit / Shareholder’s Equity

Similarly to other indicators, the ROE could be used mainly to make comparisons between other companies in the same industry. Its high value, however, does not mean immediate profit. Its role is important when a company reinvests its earnings or it pays dividend. The price of shares is mainly determined by the EPS indicator, which will be discussed later.

- **Return on assets (ROA) measures the income producing ability of a business's assets machinary, buildings, materials, etc.) To put it simply, it shows what the company can do with its assets.**

The value of ROA greatly depends on the character of the industry. Let us think of different needs for assets in the oil industry or software manufacturing. A ROA above 5 % can be regarded to be good. The formula for return on assets is:

ROA= Profit / Total assets

- **The return on investment is very similar to the ROE indicator, but it measures a somewhat different perspective. It examines the profitability of a given investment.**

ROI= Gain from investment / Cost of investment

ROI= (Gain from investment – Cost of investment) / Cost of investment

The problem of comparing companies by the metrics above is that every company measures its income in a different way. As was mentioned before, accountancy knows several price/earnings ratio categories, thus, for example some take the net income (after expenses) while others take operating income as a basis. ROI is a very popular metric because of its versatility and simplicity.

- **Return on Sales (ROS) shows the business'es profit producing ability in relation to sales. It indicates how profitable sales were after the expenses (e.g. raw material and labour) were deducted. It shows the profit per euro of sales.**

It is worth examining the trends of indicators instead of taking either only one year or a period of time as a basis. An increasing ROS indicates the company is becoming more efficient, while a decreasing ratio could signal looming financial troubles.

ROS = Profit / Sales revenue

- Stock market price is often used to measure company value as the price implies value judgement by many customers and from several aspects. **EPS**, i.e. earnings per share serves as an indicator of a company's profitability. P/E rate gives a better picture of the company's expected or planned future than the mere price of shares or the profit per one share. **P/E ratio** is Market Value per Share /Earnings per Share. The indicator expresses how much a company's earnings per one euro are worth on the market. Companies anticipating higher growth in the future have a higher P/E ratio while companies with a more uncertain future have a lower P/E ratio. We should be careful when buying shares of companies with too high P/E ratio, and especially if the P/E ratio of another company with completely similar characteristics is lower.

Efficiency indicators

The profitability indicators presented earlier can be measured only in money value. However, in productivity measurement both natural and mixed units of measurement can be applied. Efficiency indicators measure how a company uses its available resources. In economic terms, efficiency indicates how effectively a company employs its assets and liabilities. Efficiency is measured by comparing expenses and the returns gained by them. Efficiency can be expressed in many ways.

Efficiency = Return / Expenses = Output / Input = Products / Resources used

Effieciency refers to achieve the highest possible return with the expenses or realising a given return with the lowest possible expenses.

Efficiency can be examined at several levels, for example from the viewpoint of the national economy, organisations or companies, but also within companies from the aspect of particular units. Efficiency should be improved because the availability of resources is restricted, and thus inputs cannot be increased boundlessly in order to increase output. We can achieve only by increasing efficiency that our output should increase even if our resources (e.g. labour force, land) are not extended. Competitive companies offer goods and services to customers on the market always effectively.

Efficiency is measured by return on assets ratio (income/ average totals assets), which indicates how efficiently a company can manage its assets to produce profits during a period.

A high ratio shows that the company is more effectively managing its assets to produce greater amounts of net income, and further income cannot be produced by improving efficiency (only by involving further assets).

Efficiency is most frequently examined by turnover ratio indicators.

- **Turnover ratio indicates how many times *on average* the assets are returned from the income. (Net income/ Total assets). Invested capital and other resources (number of staff) can also be in the denominator.**

- Companies working with high margin and low turnover mostly produce low turnover ratio while the ones with low margin and high turnover produce high turnover ratio.

Company managers are usually interested in the rate of inventory turnover because it is an indicator that characterises a company's inventory management the best. This ratio shows how many times a company's average inventory is sold and replaced during the examined period of time. If the **turnover rate of inventory** (cost of goods sold/ average inventory) is quick, it shows not only a favourable circulation, but it can also indicate that the inventory is smaller than necessary.

The receivable turnover ratio (debtors' turnover ratio, accounts receivable turnover ratio) indicates the velocity of a company's debt collection, the number of times average receivables are turned over during a year. This ratio determines how quickly a company collects outstanding cash balances from its customers during an accounting period. (Receivables turnover ratio = Net receivable sales/ Average accounts receivables). Receivable turnover ratio indicates how many times, on average, account receivables are collected during a year (sales divided by the average of accounts receivables). A popular variant of the receivables turnover ratio is to convert it into an **Average collection period** in terms of days. The average collection period (also called Days Sales Outstanding (DSO)) is the number of days, on average, that it takes a company to collect its accounts receivables, i.e. the average number of days required to convert receivables into cash. Its calculation is: Receivables turnover ratio = Net receivable sales/ Average accounts receivables. Accounts Receivable outstanding in days: Average collection period (Days sales outstanding) = 365 / Receivables Turnover Ratio.

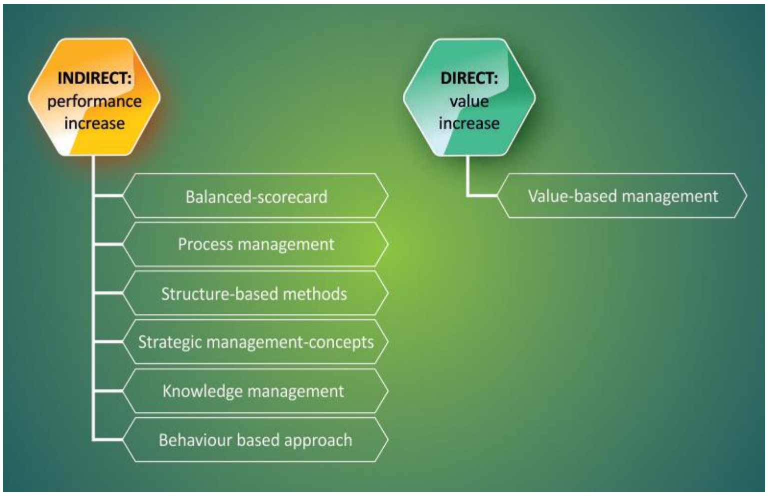
The receivable turnover ratio (customers' debt *365 / Net income) shows the average time period between the accounts being sent and being paid by the customer. Similarly, **accounts payable turnover ratio** indicates the rate at which a company pays off its suppliers.

Let us suppose that the inventory immobilization time is 34 days, the time of collecting cash balances from customers is 20 days, the time of paying off suppliers is 30 days. According to the above turnover ratios, the financing time is 34days + 20days - 30 days= 24 days. Thus the company has sufficient resources for 24 days.

The efficiency indicators per person employed characterises the utilization of labour force. However, the value of **per capita income** (net income / average number) is difficult to determine in organisations that regularly employ occasional and seasonal workers. In general we should be careful when we compare different organisations, in which case we should compare only companies which do similar activities.

11.2.3 Complex performance indicators

Complex indicators can primarily be classified into two groups. There are some indicators that focus explicitly on **company performance** while others on **company value**. Of the ones focusing on performance the best-known method is BSC, which has already been discussed in the previous chapter. One important goal of BSC is to measure the realization of action plan that can be derived from company strategy.



48. ábra: Approaches and indicators of company performance and value (Fiáth, 2008)

The BSC can not only be used as a strategy control tool, but as a tool of increasing value as well. At least it can supplement value centred management (see later). The models enumerated among the indirect tools, below the BSC focus one or more elements of company activities or value chain, such as quality, work processes or operations process.

All of them contribute to increasing company value, but they **cannot be regarded as a comprehensive system** from the point of view of value creation.

- Strategic management concepts:
  - Process-concept (concentrates on a strategic process),
  - System-concept (puts the whole company structure into the centre),
  - Cybernetic approach (treats processes as an integrated management system),
- Structure-based methods (e.g. accounting systems, internal accounting prices based on responsibility),
- Behaviour-based models (See: chapter on change management, change of company culture),
- Process management (See: chapter on operations management).

☐ Process management means the constant adjustment of company processes, namely to customers' needs and environmental and stakeholders' expectations taken in a broader sense. It is because processes create market offerings, which the company takes to customers. These days companies develop not only their processes, but they also try to subordinate their management systems to developing processes and increasing their efficiency continuously.

The BSC is a well-developed method, which can also be used well in practice. However, it does not focus enough on increasing the wealth of proprietors, which it is not aimed at, though. Its view of performance is very complex with many dimensions, in which value creation can be missing as the real goal of the model is not necessarily to increase owners' wealth. The BSC enables managers to set goals which contradict owners' interests. Therefore, next we will describe a comprehensive concept which reflects not only the expectations of stakeholders, but those of owners as well. This is value based management.

11.2.4 Value-based management (VBM)

In the last few years several new management approaches were created, the aim of which is to increase company performance. Such approaches included total quality management (TQM), the just-in-time system, flat organisations, empowerment of employees, kaizen and lean management, team building, and many others. Most proved to be successful while others failed. The most common problem in the various management approaches was that the performance goals are unclear and not properly aligned with the ultimate goal of **creating value**.

-Value-Based Management builds the whole organisation around the concept of value. Its primary goal is to maximize company value in the long run, in a sustainable manner.

According to the model, value is only created when a company invests capital at returns that exceeds the cost of that capital (interest rates on liabilities and the expected return on equity), and its goal is to maximize the return of invested capital. VBM focuses company management processes, its primary motivations and analytical techniques, etc. on creating value. VBM has the following elements:

Business planning: The organisation must develop and introduce a planning process which evaluates decisions related to strategy, investments and resources according to what extent they can increase owners' value.

Setting goals: Performance targets must be determined in such a way that they should create owner value according to risk levels.

Measurement and feedback: The achieved performance must be measured and communicated at all company levels (at the level of each unit and individual).

Inciting: Managers and employees must be incited and rewarded according to how they contributed to creating sustainable value.

The thinking behind VBM is simple and brief. The value of a company is determined by its **discounted future cash flows**. In this view, **value-based performance indicators**, such as EVA (economic value added) or cash flow return on investment (CFROI) reflect better the real business result than accounting based metrics (e.g. income before tax), earnings per share (EPS) or return on investment (ROI). A company applying VBM uses performance indicators both in making strategic decisions and everyday decisions. Next we will give an overview of some important indicators focusing on value increase.

The German BASF chemical firm puts value at the centre of company operations. Accordingly, all its employees focus on value every single day. In the firm's view, the main measure of value is the positive EBIT received after deducting capital costs (before operating profit, interest and paying tax) You can read more about the firm's relation to value below:

https://www.basf.com/group/corporate/en/investor-relations/strategy/value-based-management

11.2.5 Performance indicators focusing on value

Company evaluation methods maximizing owner value can be divided into two groups: **Discounted cash flow** (DCF) analysis uses future free cash flow projections and discounts them (most often using the weighted average cost of capital) to arrive at a present value. In the view of the indicator **economic value added** (EVA) value is indicated by the future value added.

ROIC is an indicator similar to ROI, which forms a transition between the traditional return indicators and the indicators measuring value creation. ROI indicates the profitability of a given investment, how wisely a company invests its equity, and how much cash it generates from its investments.

ROIC = NOPAT / invested capital

NOPAT = net operating profit after tax = operating profit x (1 – tax rate)

The indicator calculates with operating capital both in its numerator (net income – dividends) and in its denominator (liabilities + equity). In terms of ROIC, increasing the return does not necessarily mean value creating growth as the capital does not contain alternative costs.

One of the best known indicators focusing on value is CFROI (cash flow / market value of capital employed) that assumes the stock market sets prices based on cash flow, not on corporate performance and earnings. Furthermore, the indicator takes into consideration that the lifetime of a company's assets is finite, therefore it calculates returns on the basis of this lifetime.

Thus, CFROI can also be interpreted as an internal rate of return (IRR): in fact it is a discount rate at which the difference between the present value of cash flow from investments and the initial investment costs is zero.

IRR or internal rate of return is the economic rate of return on an investment or its growth rate. According to the definition, it is the discount rate at which the present value of all cash flow from the investment equals zero. Discount rate is similar to interest rate, it is only applied backward in time, i.e. when the present value of future cash is calculated.

According to the indicator EVA, investments create value for owners if their treturn is higher than the cost of invested capital. Unlike traditional indicators, it considers the full cost of the capital tied up in the activity.

EVA = NOPAT – (Capital x cost of capital)

The operation of a company or its unit increases company value only if it brings more income than what the capital needed for its operation cost, i.e. it produces both the interest rates paid to its creditors and the expected return of owners.

In simple terms, EVA is the profit produced by a company reduced by the cost of capital needed to generate profit. The advantage of EVA is that company managers can trace value creation (added value) by it, and thus it plays an important role in decision making. EVA calls our attention to the fact that equity also has costs (nothing is free), and thus capital consciousness appears in the organisation, which improves the efficiency of how capital is used.

Let us suppose that the owners invested 20 thousand euros in a pizzeria. If the profit from the operation of the restaurant after taxation is 10 thousand euros, the cost of capital is 5%, EVA must be calculated in the following way: 10 thousand – 20 thousand x 0.05 = 9 thousand euros.

You can read more about the advantages of EVA and its comparision with other performance measures in the article below: http://www.shareholdervalue.com/shareholder_value_research/vbm_publications/metric.pdf

The indicator market value added (MVA) represents company value on the market. the price at which it can be sold. MVA is calculated that the market value of the company (equity + liabililities) is reduced by the capital contributed by investors (shareholders and creditors), i.e. issued capital and loans. A positive MVA means that managers have created value while a negative one means they have "destroyed" value.

MVA = Company's market value – capital invested in the company

MVA **is an accumulated kind of** indicator – unlike EVA, which refers to one given period of time, for example a financial year. MVA indicates investment expectations focusing on value creation. MVA can be regarded as the accumulated present value of future EVA-values. MVA is the most common metric of owner value creation. Its advantage is that it does not take the alternative cost of capital into consideration. MVA functions the best in companies whose shares circulate on the open market. In addition, the indicator can be used in smaller, private companies as well, in firms which document their capital contributions of its owners.

If, for example, the owners of a pizzeria have contributed 20 thousand euros into the firm since its opening and the restaurant it valued at 30 thousand euros today on the market, then its MVA value is 10 thousand euros.

11.3 SUMMARY, QUESTIONS

11.3.1 Summary

Organisational performance can be measured and interpreted d along several dimensions. Although there are attempts to condense it into one single indicator, it is very difficult to evaluate company performance on the basis of one feature. However, if we wanted to evaluate performance with one indicator or only a few indicators, we would approach it from the financial side.

The main problem of performance evaluation is that organisational performance has some aspects that are difficult to measure or to express numerically. The more recent indicators approach performance in a complex way, and measure, first of all, the final result, i.e. the value created for owners. However, measuring owners' value can also be realized with financial metrics.

The BSC method is advantageous because it also examines value created not only for the owners but the many stakeholders of the company (customers, workers, society) as well. In principle, the BSC method puts owners' value at the centre, which it approaches by the value created for customers. However, according to its critics, the point gets lost among the many examined dimensions.

The most comprehensive approach is value-based management (VBA), which refers to not only indicators, but also a company philosophy, and it puts value creation at the focus of every activity. Mention must be made of the non-profit sector as well, where the main goal is to fulfil the requirements formulated by the owner or founder. Nevertheless, in their case achieving goals cannot always be expressed in money value, but other indicators can get into the foreground (e.g. output, survival in the long run, social goals).

11.3.2 Questions for self-assessment

1. What do the Key Performance Indicators (KPI) show?
2. Describe briefly the historic development of company performance indicators.
3. Along which dimensions can we classify indicators measuring company performance or value?
4. What profitability indicators do you know? What is the difference between them?
5. How can we interpret company efficiency? What indicators help in measuring it?
6. What is the difference between indirect and direct performance measurement tools?
7. What does value based management (VBM) mean and what are its elements?
8. What two main approaches do company evaluation methods focusing on value have?
9. Interpret the CFROI indicator.
10. What is the difference between the EVA and MVA indicators?

11.3.3 Practice tests

1. Towards the end of the 20^{th} century the indicators examining the market value of companies were gradually replaced by accounting result categories. (True / False)
2. The ROE indicator measures the income producing ability of a company's assets (machinery, buildings, materials, etc.) (True / False)
3. The return on sales (ROS) indicates a company's return producing ability in relation to profit. (True / False)
4. The P/E indicator is the market price per share divided by earnings per share. (True / False)
5. Companies anticipating higher growth in the future have a lower P/E ratio than companies with a more uncertain future. (True / False)
6. Turnover ratio indicates how many times *on average* the assets are returned from the income. (True / False)

7. The BSC builds the whole organisation around its concept of value. (True / False)
8. A company takes discounted future cash flows as the basis of its value. (True / False)
9. The EVA indicator forms a transition between traditional return indicators and indicators measuring value creation. (True / False)
10. The MVA is an accumulated kind of indicator, unlike EVA, which refers to one given period of time, for example, a financial year. (True / False)

12. SUMMARY

12.1 SUMMARY OF COURSE MATERIAL

The course titled *Resource management* examined the operation of organisations involving several areas of science from the point of view of how the resources needed to perform activities are acquired and employed effectively and efficiently. In order to survive successfully in the long run, organisations must be prepared to adapt to the continuous change of the environment, to ward off and manage risk factors on a continuous basis. Therefore organisations must plan their actions affecting the future, and the management of resources required by them consciously.

In the first half of the course material (Lessons 1-6) we discussed strategy planning. In the process of **strategic planning** a company assesses the factors of environment affecting the company, and estimates their change in the future. It examines the different areas of activities executed so far and how successful the business has been. On the basis of all these the company plans the directions and goals on which it intends to manage its operation in the future.

The strategic planning process can start as a determination of the top level management or on a so called "bottom-up" initiative. It is triggered by conscious planning or recognising some kind of a problem. In the latter case after examining the problem carefully, the internal and external environment of the company will be analysed. It is important to examine the results of how similar problems were solved earlier. Taking all these into consideration, strategy will be created, and then implemented. It must, however, be noted that the process is not over yet as during the planned period of time and also after it, it must be continuously examined how the plans were realised. It enables the management to take actions to correct activities which are not effective enough even in their progress or later.

Depending on what **time frame** the plan is made for, we can differentiate strategic, business and operative (tactical) plans.

The various plans affect the various levels of the business. Strategy planning is the task of top management and encompasses the whole company. A business plan, division plan is broken down from strategy, is designed by middle-level management and encompasses all the business units. Functional plans are created at the lower-level management, refer to certain functional units, departments and comprise all measures and actions which are necessary to achieve the goals formulated in the strategy.

The factors surrounding and influencing the activities of the business make up **the external environment of a business**, which can be interpreted at three levels, and thus we can talk about the macro-, industry and micro-environment of a business. The three levels require different methods of analysis. Of the methods used for **analysing the macro-environment** the most common ones are: the PESTEL-analysis, the STEEPLE-analysis and the Diamond-model. For the analysis of industry-environment we introduced Porter's five forces model and Industry life cycles model. Finally, we discussed Strategic group analysis, Strategic map and Customer value analysis among the methods applied for **analysing the immediate operational environment**.

The presented methods enable us to get acquainted with the state and change of a business's environment and the impact of particular elements on the business. In addition to analysing the impact of the external environment of the business, the business must also consider its **internal resources and competences** in order to create a successful strategy. The value creating process of a business is realized by means of resources, and this is how a business can gain competitive advantage against competitors.

Resources can be classified into main two groups: tangible and intangible resources. The former involves financial, physical and human resources while the latter refers to technological and innovation resources, structural and relationship capital, and reputation.

Assessing resources according to the **VRIO-**system, we can determine which ones mean competitive advantage for a business. In addition to resources, it is also crucial to consider the business's competencies for the creation of strategy later. **The resource-based view of strategy** prepares the creation of strategy by evaluating resources and competencies in 5 steps.

The method used commonly for assessing resources and the impacts of the environment together is SWOT-analysis, which evaluates the internal capabilities of a company (strengths and weaknesses) together with the environmental impacts (opportunities and threats). In the case of the latter, there is a further possibility of analysis, namely the Effect/probability analysis. The SWOT-analysis enables a company to create the basic strategy that it intends to follow.

After considering and assessing external and internal resources, an important task is to develop the basic principles of **competitive strategy**. **According to the competitive situation** strategies can be divided into various groups, such as cost leadership, differentiation, concentration, differentiation focus and low-cost focus strategy. **According to the response to the environment** we can differentiate defenders, prospectors, analysers and reactors.

On the basis of the competitive situation and market growth rate, strategies can be interpreted in four dimensions, according to whether the competitive situation is strong or weak, and related to it whether the market growth rate is slow or fast. **In terms of orientation** we can distinguish between consumer-oriented, company-oriented and competitor-oriented strategies. It is important to point out that in the various life cycles of companies and industries different strategies can be used, and thus it must also be taken into consideration when choosing a competitive strategy.

The competitive strategy having been chosen, corresponding plans will be developed. **A business plan** will be created from the strategic plan, and it is made for a short period time of 1-3 years. Business plans have different **purposes**, but the most important ones are perhaps made for the company's internal purposes, determining goals and measures necessary for achieving goals, for a financial institution due to taking out credits as well as informing proprietors.

Planning – although the future is always uncertain – is important for a company to prepare for expected events, assess risks, and outline solution if they should happen. Planning facilitates a company's ability to adapt flexibly to challenges of the environment. Furthermore, it guides a company's activities, motivates those who are concerned, and provides a basis for measuring efficiency.

A good business plan meets the **requirements** of reality, complexity, consistency and flexibility, helps the work of management, incites and appeals to investors. A business plan can be made statically (for a given point of time) or dynamically (for a given period of time). As for the data used, the risk of planning can also be different. During the process of planning, first a diagnosis is made, then a prognosis is determined, which is followed by formulating goals and aligning resources with goals. On the basis of these, action plans, measurement plans can be made, the realization of which must be monitored, and the results of control must be built into the next planning process. The structure of a business plan depends on what purpose and for who it is made. In general, **its chapters** are: Introduction, general data; Executive summary; Business description; Environment description, characteristics of the industry; Marketing plan; Functional and operational plan; Organisational and human resources plan; Risk assessment and plan; Financial, financing plan and Appendices.

In the second half of the course material (Lessons 7-12) we discussed the different aspects of implementing and controlling strategy and the related company activities.

Operations management deals with analysing, planning, implementing and controlling operations and service processes. It involves the responsibility that the business processes should function effectively, and thus the company should use the fewest possible resources by which even product criteria and consumers' needs can be fully satisfied. We got acquainted with such efficiency increasing tool as Lean, TQM, JIT and JIS.

Finance is the study of how individuals, organisations and countries manage their financial resources. Finance is important because every individual and company encounters decisions related to obtaining and spending money. It is possible to assess the organisations' financial processes and financial state on the basis of the cash flow statement, income statement and balance sheet. The cash flow statement shows the quantity of the cash available, the income statement shows profits and losses while the balance sheet shows the company's capital.

Marketing helps an organisation to achieve its market goals, and thus besides operations and finances, it is one of the most important company activities. The goal of marketing activity is to facilitate the mutually fruitful relationship of organisations with customers, involving getting to know customers' needs, strategy creation, marketing tactics (marketing-mix), customer relationship management and customer recognition as a result of all those.

Organisations operate in a constantly changing environment. A conscious **change management** create competitive advantage for companies as they can change quickly and effectively by it, in order to satisfy market needs better and more effectively. Change management deals with the people (soft) side of organisational changes and appears at every level of the organisation: at the highest, middle and lowest level. If change management is done well, people will feel that they have also been able to contribute to the organisation, and by this they will be work more committedly towards the new common goals.

We have already discussed the process of strategic management. **Controlling the results of strategy continuously** is a neglected field although it can help an organisation significantly to develop its business processes and to achieve its goals in a changing market environment. Strategy control has four steps: (1) defining performance criteria, (2) measuring performance, (3) analysing deviations and (4) taking corrective actions.

The course material was finished by examining **organisational performance** as eventually it is performance that shows how well we managed our resources. However, performance can be measured and interpreted along several different dimensions. Although there are attempts to condense it into one single indicator, it is very difficult to evaluate company performance on the basis of one feature. However, if we wanted to evaluate performance with one indicator or only a few indicators, we would approach it **from the financial side**. However, the more recent indicators examine and measure performance in a complex way, and put, first of all, the final result, i.e. the value created for owners at the centre.

12.2 CLOSING

We have arrived at the end of our course titled *Resource management in a competitive environment*. We hope that it was not difficult for you to acquire the material. Please have a look at the sources given in the literature, check your knowledge by doing the tests, and search the internet for practical exercises by using particular key-words of the relevant lessons. We wish you good luck with your exam.

13. APPENDICES

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13.3 GLOSSARY, INTERPRETATION OF KEY TERMS

1. **Action programmes:** measurement plans broken down from the strategy, created as part of the business plan, which determine for each business unit of a company the concrete activities and

processes to be done by which the goals set in the plan can be achieved.

2. **Audit**: Audit is primarily a quality improvement process in which organisational performance is evaluated relative to a pre- determined criterion or performance standard (comprehensive performance indicator).
3. **Balance sheet**: The balance sheet is a record which indicates the structure of the assets at a given point in time as well as the financing resources of these elements of assets.
4. **Benchmarking**: In the process of benchmarking we compare the different aspects of the processes of the organisation to the best practice, usually within our sector.
5. **Brand**: is a name an expression, sign, symbol, plan or the combination of these aimed at identifying the product or service and differentiating it from the product of competitors. In a broader sense, brand is everything that the brand means for the customer. Brand building- and management is the most important task of marketers. The brand exists in the customer's head. In fact, brand is the company's promise to offer definite product features, benefits and experiences in a balanced way.
6. **Business plan**: A business plan formulates for the whole of the company the goals meant to be achieved for the period of the following 1-3 years, as well as the means needed for achieving the goals and influencing the future broken down on the different business units of a company. Thus, based on the strategy, plans such as the purchase plan, marketing plan, sales plan, financial plan or human resources plan will be made. Besides, the task of the business plan is to coordinate the above mentioned business units on a strategic basis**.**
7. **Cash flow from financing activities**: shows the changes in the size and structure of the company's own capital, the loans and credits taken out. The financing cash flow with a too high positive sign refers to involving considerable external resources.
8. **Cash flow from investing activities**: shows the cash flows and the relevant changes in finances related to the long-term investments of the business (e.g. physical resources, immaterial goods and long-term securities) as well as to the selling of invested resources.

9. **Cash-flow:** Cash flow means the process of accumulating and using resources during a definite period of time (Cash flow = cash inflow – cash outflow). It value is equivalent with the difference between the actual cash inflows and the actual cash outflows. In financial terms, a company can be considered to be healthy if it is able to produce enough money to pay its creditors, employees, suppliers and proprietors.
10. **CFROI**: cash flow return on investment (cash flow/ market value of capital employed) assumes that the stock market sets prices based on cash flow, not on corporate performance and earnings.
11. **Change management**: is the sum total of processes, tools and techniques, which the people side of organisational changes can be dealt with so that the organisation would achieve the business results aimed at. In more concrete terms, change management helps employees to accept, build in and make use of the change in their everyday work.
12. **Competence:** refers to the suitability of some resource combination to carry out a task or activity in an integrated operation.
13. **Competitive strategy**: strategies aimed at achieving competitive advantage against other participants within the frame of industry environment.
14. **Concept development**: During the process of concept development, some products (their description or prototype) are presented for customers, and they are asked about their opinion. Customers will be asked how they evaluate the advantages of the product, whether they would buy it, what other product satisfies the same demand, or at what price they would buy the product.
15. **Corporate strategy**: deals with a company's comprehensive goals, organisational structure and the relationship between the particular functional units and the centre.
16. **Corporation**: The form of business managing with biggest capital is a corporation, in which propriety and management are separated from each other.
17. **Customer equity:** customer equity is the sum of all customers' CLVs (customer lifetime values).
18. **Customer relationship management:** (CRM) In a narrow sense, by means of customer relationship management (CRM) companies build an information database about shopping and different

interactions with customers. In a broad sense, CRM comprises all activities that the company does in order to acquire, keep customers and to increase their number. In this interpretation CRM is perhaps the most important activity in marketing.

19. **Customer value**: is the difference between all the perceived benefits of the product (use-value, recognition from friends, etc.) Customer value and all the perceived costs (money, time and energy spent purchasing it).
20. **Customer-lifetime value**: A satisfied customer is loyal to the company and increases the so called *Customer Lifetime Value - CLV*, i.e. the net present value of all products and services that the customer bought from the company during his/her life.
21. **Customer-oriented company**: The goal of a customer-oriented company (marketing conception) is to get to know customers' needs, and to satisfy them better than the competitors.
22. **Declining industry**: From the point of view of strategic analysis, such an industry can be regarded as declining in which sales volume decreases over a longer period in the absolute sense. According to the life cycles model, the decline stage of an industry is characterised by decreasing profit margin, curtailed product range, decreasing research, development and advertising activities as well as proliferation of competitors.
23. **Demand**: is the solvent want appearing on the market.
24. **Dynamic capabilities:** are definite processes of the company which achieve market changes by integrating, reconfiguring, organizing and selling resources, namely they enable the company to adapt to changes. Dynamic capabilities are such organisational and strategic routines that create new resource-configurations while new markets appear, get combined, separated or stop.
25. **Effect/Probability analysis** is meant for the further categorisation of the external factors of SWOT. The environmental factors must be examined along two dimensions. The environmental factors must be examined along two dimensions. On the one hand, it must be estimated what the likelihood is that the threat or opportunity will happen, on the other hand, it must be assessed that if it should happen, what impact it will have on the company.

26. **Effectiveness**: expresses whether a given activity or expense has a result or effect, whether the expected change happens, which we made efforts for.

27. **Efficiency:** refers to achieving the highest possible return with the expenses or realising a given return with the lowest possible expenses. We are efficient if we achieve a good result with relatively few expenses (time, money, energy), too. The formula of efficiency is results/invested resources, output/input, financially incomes/expenses.

28. **Emerging industry:** Emerging industries: newly formed or reformed industries that have been created by technological innovations, shifts in relative cost relationships, emergence of new consumers' needs, or other economic and sociological changes that elevate a new product or service to the level of a potentially viable business opportunity.

29. **Environment*:*** Environment for a company means all the factors which have an effect on the operation of an organisation in the present or in the future. An analysis of the environment outlines a picture of the change of the external factors affecting the organisation – considered important from certain aspects – at a time horizon determined the strategy to be formulated.

30. **EVA**: According to the indicator EVA, investments create value for owners if their return is higher than the cost of invested capital. Unlike traditional indicators, it considers the full cost of the capital tied up in the activity.

31. **Financing decisions**: influence the source side of the organisations balance. They give an answer to what extent the organisation finances its assets (investments) by equity, long-term liabilities and short-term liabilities.

32. **Goal of analysing the environment**: The goal of analysing the environment is to state how the potential opportunities and threats can be used for the benefit of the company: to make use of favourable opportunities, to avoid and fend off threats shattering company positions.

33. **Income statement:** The income statement details the incomes and expenses of a given period of time (typically a business year) and as their difference the profits and losses of the business. The purpose of the income statement is that the persons concerned (proprietors, investors and lenders) can assess the performance

of the company in a given period of time; draw conclusions from this about its future performance, and assess future risks as well as make decisions on the dividend payment.

34. **Industry**: refers to a group of companies which produce products/services of the same type or which can be replaced by each other. This domain is the territory of competition strategies.
35. **Investment decisions**: are made on capital budgeting. In it the company examines whether it is worth financially executing its planned investments (e.g. building a new plant). Most organisations try to buy assets which increase the value of the organisation to the greatest extent.
36. **Just-In-Time** (**JIT**) is a manufaturing organisation and inventory management strategy of Japanese origin, which improves the company's operations efficiency by reducing considerably the factory's stock in process and the related cost. The process relies on a system of signals easy to use, which are called kanban (”tickets”). The work units involved in the manufaturing process chain express by these signals their need for the previous link in the chain, and their performance for the next one. The kanban system can be used on such production lines where the production volume falls between the lower limit of the medium serial production and the mass production. This manufaturing method results in short set-up time and little stock, which is the most important cost component in manufacturing today.
37. **Just-in-sequence (JIS)**: In JIS the spare parts arrive at the production line just when they are needed, when they are assembled in. The conditions for developing JIS supply system almost entirely correspond to the principles of Lean philosophy, since in both cases the primary goal is to reveal losses and their causes, to identify the unnecessary elements in the system, and to make them useful or remove them from the system.
38. **Lean**: Lean management is originated from its comparison with the traditional, classic mass production. Lean creates (more) value for customers by using fewer employees, fewer means, less time, less space and by using fewer resources.
39. **Limited Liability Company** (LLC): A LLC forms an ideal transition between limited companies and corporations since proprietors are liable for the debts of the company only up to their capital

contribution to the business and they do not have to choose double taxation, either.

40. **Marketing mix or 4Ps**: *E. Jerome McCarthy* (1960) classified the whole range of decisions related to marketing into four main groups; he made a distinction between decisions related to the Product, the Price, the Place and the Promotion.
41. **Marketing strategy**: Marketing strategy means higher level decisions which deal with choosing the target market (customers, clientele) and formulating the offer of the company.
42. **Marketing tactics**: follow the creation of strategy. It comprises the definite features of a product, its price, the ways of how the product gets to the customer and the applied techniques of promotion.
43. **Marketing**: According to the definition of the *American Marketing Association,* marketing is the activity, set of institutions, and processes for creating, communicating, delivering, and exchanging offerings that have value for customers, clients, partners, and society at large.
44. **Monitoring**: By monitoring the management gets feedback about whether its decisions lead the company to the set goals as well as how much progress was made towards the goals. Based on monitoring, managers can modify their decisions.
45. **MVA**: The indicator market value added (MVA) represents company value on the market, the price at which it can be sold. MVA is calculated that the market value of the company (equity + liabilities) is reduced by the capital contributed by investors (shareholders and creditors), i.e. issued capital and loans. A positive MVA means that managers have created value while a negative one means they have “destroyed” value.
46. **Need**: Need is a feeling of want which entices you to act and to buy.
47. **New-product marketing:** deals with designing, testing and introducing new products into the market.
48. **Operating cash flow**: shows the change in finances (e.g. income from sales, paying suppliers, paying wages and depreciation) resulting from the normal operative activities of the business (e.g. product sales and offering services).

49. **Operations management**: In simple terms, operations management refers to turning the inputs (labour, infrastructure, raw materials, etc.) necessary for operations into products and services for both the internal and external customers of a company.
50. **Operations strategy**: describes the aspects of the company strategy related to operations.
51. **Operations-centred company:** Operations-centred companies set high productivity (high product/expenses ratio), a low cost level and a wide range of distribution as a goal for themselves.
52. **Organisation development**: Organisation development (OD) is tool for increasing organisational efficiency, which turns to behaviour- and society sciences for help in order to facilitate organisational change. Instead of a symptomatic treatment, it focuses on realising lasting organisational changes, solving real problems; and enhancing the learning abilities and self-development of the organisation.
53. **Organisational culture**: is the sum total of values and behaviour norms which form the unique psychological character of an organisation. Organisational culture comprises the expectations, experience, philosophy and values of the organisation which keep the organisation together; and which are expressed in the self-image of the organisation. It manifest itself in such written and unwritten rules, common attitudes, beliefs and habits which are formed by time, and which are accepted by the members of the organisation.
54. **Partnership:** Partnerships are organisations established by several persons, who can involve more resources in the business since the business partner offering the capital can become a proprietor: in return for his money, he can get a share in the business.
55. **Present value (PV):** is a term of economics expressing the time value of money. It expresses how much 100 euros received in the future will be worth today. By reverse logic we can get to a similar term, the future worth of money: how much the value of present 100 euros will be at a given future point of time. The present and future value of money depends primarily on the bank interest rate or some kind of expected return. If the expected return (interest rate) is high, the future value of 100 euros will also be high while the present value of 100 euros received in the future will be low.

56. **Product:** A product can be anything – an object, a service, an event, a person, a place, an organisation, an idea, or their mixture –, that can be offered to customers in order to satisfy their needs.
57. **Product-oriented companies**: try to manufacture the best-quality, most innovative and high- performance product.
58. **Prototype**: A prototype is an early pattern or model aimed at testing a product concept. The prototype representing the concept goes through technical and customer testing. Testing within a company is called alpha testing and testing carried out among customers is called beta testing.
59. **Quality:** refers to all the characteristics of the product or service that influence its ability to satisfy customers' needs. In fact, good quality is what the customer regards as good. The two primary dimensions of quality are performance and conformance. A Mercedes is quicker, more comfortable and safer than a Suzuki, but a Suzuki is of good quality it performs in a reliable way what the factory promises if it meets the customer's need.
60. R**eciprocal cause-effect matrix:** shows what elements of market strategy must be taken into consideration when certain influencing factors are dominant.
61. **Resources:** mean inputs for the value creating processes of a company in a broader sense.
62. **Return on marketing investments (MROI)**: is the net profit generated by marketing investments in relation to the expenses of marketing investments.
63. **Risk**: risk in finances means the probability that the actual return of the investment will be lower than the expected return.
64. **ROA**: Return on assets (ROA) measures the income producing ability of a business's assets machinery, buildings, materials, etc.) To put it simply, it shows what the company can do with its assets.
65. **ROE:** Return on equity (ROE) is the main measure of the profitability of owner's equity (shareholder value). It shows how effectively a firm generates profit in relation to the unit of shareholder's equity.

66. **ROI**: The return on investment (ROI) is very similar to the ROE indicator, but it measures a somewhat different perspective. It examines the profitability of a given investment.
67. **ROIC:** ROIC (return on invested capital= [net income – dividends] / total capital) is an indicator similar to ROI, which forms a transition between the traditional return indicators and the indicators measuring value creation. ROIC indicates the profitability of a given investment, how wisely a company invests its equity, and how much cash it generates from its investments.
68. **ROS**: Return on Sales (ROS) shows the business's profit producing ability in relation to sales. It indicates how profitable sales were after the expenses (e.g. raw material and labour) were deducted. It shows the profit per euro of sales.
69. **Sales-oriented companies**: apply aggressive sales techniques (personal visit, persuasion, convincing and machine- like repeated messages.
70. **Scenario:** Scenarios are such prospects for the future which present the impact of several important environmental factors on our strategy.
71. **Service:** A service is an activity that somebody does in order to satisfy another person's needs. Unlike a product, a service does not result in proprietorship
72. **Six sigma**: Six sigma refer to a quality assurance system, which facilitates the stability and calculability of company processes. The main point of the system is that the failure rate should be less than 3,4 in 1000.000.
73. **Society-centred company:** A society-centred company develops a strategy which improves not only the consumer's but the society' well-being as well, i.e. it takes the aspects of both environment and health into consideration.
74. **Sole proprietorship**: Sole proprietorship is liable for the debts of the company solely and with its whole wealth as well as is entitled for its profit.
75. **Stock:** During the operations processes the movements of goods can be stopped, and during the halt a certain amount of products can appear, which is called stock. It is necessary to have a certain stock level in order ensure the continuous internal movement of the materials and semi-finished.

76. **Strategic business units**: Strategic business units are such separable areas of business within the company which represent well-definable product-market combinations, and their competition position and efficiency can be assessed separately
77. **Strategic group**: a group of the companies in an industry, the members of which follow a similar or the same strategy, serve the same market segments, use nearly the same sources and resources, and consequently, they respond to market opportunities and threats in a similar way.
78. **Strategic map**: illustrates the position of the company relative to its competitors in two dimensions. The two dimensions refer to the two parameters which are the most important from the company's point of view.
79. **Supply chain**: The sum total of operations processes is called supply-chain. It ranges from winning the raw material to delivering the finished product to the end user, and thus it also comprises the purchasing processes prior to manufacturing or offering services. By the supply-chain management, companies purchase the necessary inputs (raw materials, spare parts and machinery), turn them into finished products and then deliver the products to their destination.
80. **SWOT-analysis:** A SWOT-analysis is a widely used method for analysing the impact factors of the company's resources and the external environment together. SWOT is an acronym which is composed of the initials of the English words for the categories: Strengths, Weaknesses, Opportunities and Threats. (GYELV is its Hungarian equivalent).
81. **Technology**: In simple terms, technology is applying technological knowledge in operations and services.
82. **Turnover ratio:** indicates how many times *on average* the assets are returned from the income. (Net income/ Total assets). Invested capital and other resources (number of staff) can also be in the denominator.
83. **Value Based Management**: builds the whole organisation around the concept of value. Its primary goal is to maximize company value in the long run, in a sustainable manner.
84. **Want**: is a need influenced by culture and personality.

14. TESTS

14.1 PRACTICE TESTS

14.1.1 Multiple choice tests

1. What does not belong to the primary goals of strategy? There are several good answers. For a wrong answer a point will be reduced from your test score.

a. determines the tool systems of achieving and maintaining competitive advantage
b. determines the future goals of an organisation for a given time span
c. determines with supplier to break a contract with
d. provides foundations for meeting proprietors' expectations.
e. provides foundations for proprietors' dreams
f. employs new people in order to achieve goals
g. acquires the necessary resources

2. The environment of an organisation

a, is what surrounds the company.
b, factors which have an impact on the business.
c, means the natural environment.
d, means the time horizon.

3. The goal of analysing the environment is
a, to assess the factors affecting the company and their consequences.
b, to assess the available natural resources.
c, to examine what the business has an impact on.
d, to set limits to our activities.

4. Transparent environment
a, is slow and produces calculable change.
b, is planned with simulation.
c, can be modelled easily.
d, experts' prognosis must be considered in planning.

5. When examining the macro-environment, we analyse
   a, consumers' expectations to the product
   b, competitors' behaviour.
   c, the political, legal system.
   d, the internal capacities of the company.

6. In Porter's five-forces model we do not examine
   a, threats by substitute products.
   b, the concentration of customers.
   c, capital need for entry into the market
   d, the function of economic system.

7. Choose the characteristics by which a competence can be qualified as a core competence. (There are several correct answers).

   a) contributes to achieving good company morale,
   b) an autocratic management style,
   c) is easy to imitate,
   e) extraordinary, unique technologies,
   f) the capability of imitating and following competitors quickly,
   g) brand building capability,
   h) competence that can be used in the case of any product,
   I) has market influencing effect,
   j) considerably influences values provided for customers,
   k) provide access to various markets.

True-false statements: Write T (for true) and F (for false) next to the statements below.

1. A strategic plan is made for a short (several months) time frame for particular business units of a company.
2. The adaptive approach of strategy is characteristic of businesses which work in an extremely complicated environment.
3. In analysing consumer value it must be examined how well the company meets consumers' needs compared the products of the company with those of competitors.
4. A strategy table is a diagnostic tool, which indicates how a company can adapt to the legal system.
5. Dynamism means how complicated, multi-factored the environment is in which the company functions.

6. In the case of a complex environment the method of planning is writing scenario.
7. An analysis of inflation and unemployment is part of the analysis of macro-environment.
8. The resource-based approach examines the internal resources of a company.
9. A tangible resource is, for example, trademark.
10. Competitive advantage often comes from intangible resources.
11. Products that can be imitated easily mean comparative advantage relative to competitors in the long run.
12. An important feature of core competences is that they are product specific.
13. The success of strategic business units can be assessed in relation with that of the other areas of a company.
14. The wheel of competitive strategy shows the key areas of environmental factors needed for corporate strategy.
15. In concentrating strategy the goal is to reach only a narrow consumer group on the target market.
16. Low cost strategy means that the company appears on the market with a wide range of products with low prices at low-cost level.
17. Defenders require a stable environment while prospectors adapt well to the dynamic change of the environment.
18. The strategy is broken down from the business plan.
19. The business plan is typically made for a period of 1-3 years.
20. The risk of operation is decreased by planning.
21. The adaptation ability and flexibility of the business decrease by planning as they have to comply with the goals of planning.
22. A company makes a business plan usually for its internal goals, creditors or competitors.
23. The EVA indicator forms a transition between traditional return indicators and the indicators measuring value creation.
24. The MVA is an accumulated kind of indicator, unlike EVA, which refers to one given period of time, for example, a financial year.
25. The ADKAR mode helps change management to be able to focus on particular aspects and results of change separately.
26. In Lewin’s model the behaviour of the individual (B) can be described by the following formula $B = P+E$, where P refers to the environment and E refers to the personality of the individual.

27. Operations management encompasses several planning, managing and controlling processes, the aim of which is to make sure that the product gets to the customer.
28. Operations management cannot be interpreted in the case of services.
29. According to the principle of lean all company activities must be eliminated that do not create value for customers.
30. The BSC lays the main emphasis on financial processes.

MOCK EXAM

1. 1. Practise the concept of strategy! Match the elements of strategy and their characteristic features.

a, ploy	1. situation
b, perspective	2. environment
c, pattern	3. goal
d, plan	4. competitor
e, position	5. behaviour

2. What time frames are company plans made for, and what are they called? Put in the relevant expressions. Start with the highest level plan.

 1. ……………………….. time frame: …………………….. plan
 2. ……………………….. time frame: …………………….. plan
 3. ……………………….. time frame: …………………….. plan

3. What are the factors examined by the Porter's five forces-model? Choose the right answers. (There are several good answers). For a wrong answer a point will be reduced from your score.)

 a, inflation

 b, natural environment

 c, the opportunities of competitors

 d, economic serial size

 e, substitute products

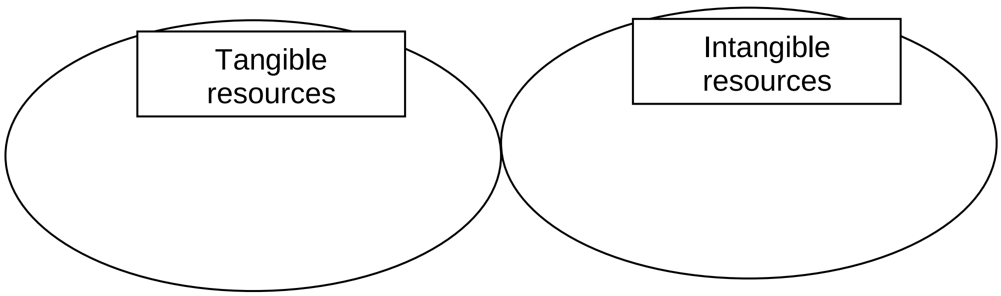
f, industry life-cycle
g, differentiation of the product available in the industry
h, strategic group
i, built-in switching cost

4. Compare the fields of the PESTEL- and STEEPLE-analysis.

P: ………………………………	S: ………………………………
E: ………………………………	T: ………………………………
S: ………………………………	E: ………………………………
T: ………………………………	E: ………………………………
E: ………………………………	P: ………………………………
L: ………………………………	L: ………………………………
E: ………………………………	

5. Put the resources below into the right group.

big warehouse, lorry, law qualification of manager, patent, long term investment credit, stocks, democratic management style, know how, research instruments of high standard, positive market brand, stable liquidity, good company morale, fuel base.



6. Which strategies are recommended for which industry life-cycle? Match the industry life-cycle and strategy. More than one strategy can belong to one industry-cycle.

Character of industry life cycle	**Environmental features**

(1) Emerging industry	a) Sophisticated cost analysis
(2) Growth and maturity	b) Filling a gap in the market
(3) Declining industry	c) Harvesting
	d) Developing industry structure
	e) Shifting mobility barriers
	f) Technological innovation and production planning

7. Match the strategy and its definition.

Strategy	Features of strategy
(1) Customer-oriented strategy	a) aimed at to enable the company to acquire such high market share, and to achieve such high levels of economic efficiency as possible.
(2) Company-oriented strategy	b)The basis of preparing this strategy involves discovering customers' needs, market segmentation, targeting and positioning.
(3) Competitor-oriented strategy	c) focuses on a favourable attribute which ensures differentiation from competitors, and the primary goal is to develop this.

8. What is the correct order of the planning process?
Put the right number in front of the particular steps of planning?

…………. Monitoring
…………. Prognosis
…………. Action programmes
…………. Diagnosis
…………. Assessment of resources
…………. Formulation of goals

9. Which are is more emphasized in the particular business plans? Match the plan prepared with a particular goal and the parts of planning which are emphasized.

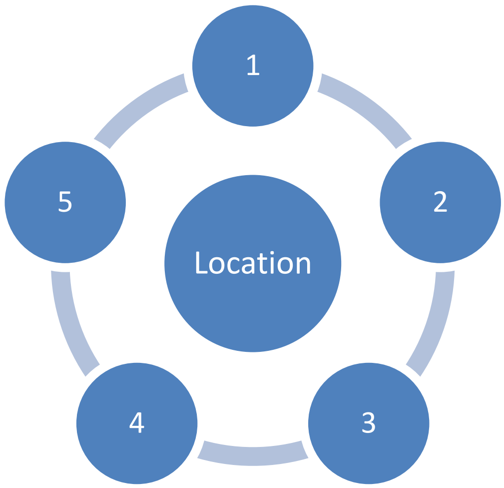
Plan	Emphasized area
(1) A business plan for investors	a) the processes of the business, the success, efficiency and profitability of its operation

(2) A business plan for proprietors	b) both textual description and calculations
(3) A business plan for external partners	c) tasks and resources as well as their financing
(4) A business plan for the goals of internal use	d) financing and return
(5) A business plan of a non-profit firm	e) realising professional tasks

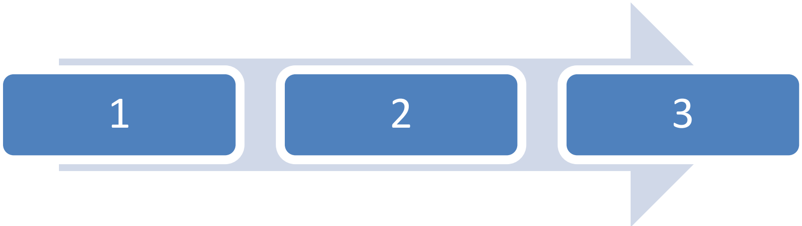
10. Match the type of risk and its characteristics.

Risk	**The characteristic of risk**
(1) Risky data	a) we have a full range of information about the circumstance
(2) Certain data	b) there isn't a full range of information about the circumstance available
(3) Uncertain data	c) there are only some uncertain data available

1. What factors influence the geographical locations of companies and where they put theirs plants?



2. What are the main steps of operations management?



3. Match items from the two columns

a) LLC.	1. is liable for the debts of the company solely and is liable with its whole wealth as well as is entitled for its profit.
b) Corporation	2. are organisations established by several persons , which can involve more resources in the business than sole proprietorships
c) Sole proprietor-ship	3. forms an ideal transition between limited companies and corporations since proprie-tors are liable for the debts of the company only up to their capital contribution to the business and they do not have to choose double taxation, either. 4.
d) Partnerships	5. The form of business managing with biggest capital

4. Put the categories below into the right column.

Assets, Liabilities, Stockholders' equity, Current liabilities, Non-current lia-bilities, Non-current Assets, Current Assets

5. Match the items in the two columns.

a) ROA	1. …before paying interest and tax
b) ROI	2. …in relation to investments
c) MVA	3. …in relation to the cost of capital of a form
d) EBIT	4. ...in relation to cost of invest-ment

e) EVA	5. …in relation to assets

6. Match the items in the two columns.

a) need	1. a need influenced by culture and personality
b) want	2. a feeling of lack which incites you to act and buy
c) demand	3. a solvent want appearing on the market

7. Identify the company philosophies (orientations) with the help given in the boxes.

8. Put the stages of Lewin's change management model into the right place.

1. The members of organisation must question the credibility of the old, routine-like organisational features: ……………………………….
2. Organisational transformation according to plans: ……………………….
3. Ensuring the stability of target state: ………………………

9. Calculate the EVA indicator according the example below.

Let us suppose that the owners invested 20 thousand euros into their business. It the net operating profit after tax is 15 thousand euros, the cost of capital is 10%, what will be the value of the business according to the EVA indicator? Help: EVA= NOPAT- (capital employed * cost of capital).

10. Calculate the MVA indicator according to the example below.

Let us suppose that the owners of a company have invested 30 thousand euros into their firm since it was opened and now the firm is valued at 30 thousand euros at the market. How much is the value of change according to the MVA indicator? Help: MVA= company's market value-invested capital.

FINAL EXAM

1. What types of plans are made at the various levels of management? Match the management levels with the related types of plan and the affected company areas. More than one type of plan can belong to one management level and one company area.
(16 points)

Management level	**Type of plan**	**Affected company area**
A) Top management	1. prospects for the future	a. the whole corporate
	2. business plan	
B) Middle-management	3. action programme	b. one particular business unit, division
	4. tactical plan	
C) Lower-level management	5. vision	c. one particular functional unit or department
	6. strategic plan	
	7. philosophy	
	8. mission	

2. Match the various characteristics with the particular types of strategy mode. More than one characteristic can belong to one approach. (7 points)

Type of approach	**Characteristics**
A) Entrepreneurial mode	a) typically businessmen running one-person businesses
B) Adaptive mode	b) system-view planning
C) Planning	c)"reactive solutions" (reactions) to the challenge of the environment
	d) the mail goal is growth
	e) disconnected decisions
	f) typical of businesses which work

	in an extremely complicated environment
	g) "the policy of big steps", puts a brave face to an uncertain future

3. Match the various characteristics with the particular types of strategy mode. More than one characteristic can belong to one approach. (7 points)

Type of approach	Characteristics
A) Entrepreneurial mode	h) the environment can be shaped
B) Adaptive mode	i) integration of strategy and related decisions
C) Planning mode	j) active influence of the events
	k) an important participant of planning is the analyser
	l) there are no clearly determined goals
	m) non-initiative type of actions
	o) strategy is guided by searching for new possibilities

4. Match the given type of plan with its characteristics. (5 points)

Type of plan	Characteristics
A) A strategic plan	a) is prepared for a short time span related to particular business units.
B) A business unit plan	b) its important role is to coordinate the company's business units on a strategic basis.
C) Functional plans	c) contains the concrete means of achieving business unit goals, the steps of the activities to be performed their length of time, date,

	cost and resource needs, responsibilities and duties and the expected results must be accurately determined in the plan.
D) A business plan	d) is made by the middle-management for particular business units, contains special goals, tasks and activities as well as it organises the implementation of plans and cooperates in controlling, provides data for top–level management.
E) An action plan	e) fixes the most important goals, the results to be achieved and the methods of achieving goals

5. Match the relevant characteristics with the model in which they are applied. (8 points)

Model	**Characteristics**
(1) PESTEL-analysis	(a) analysing of corporate strategy and the context of competition
(2) Porter's five forces model	(b) examining the real needs of customers
(3) Industry life-cycle model	(c) analysing the natural environment
(4) Customer value analysis	(d) analysing capital need
(5) Strategic group analysis	(e) the rate of sales growth
(6) Strategic planning	(f) the company's position compared to that of competitors
(7) STEEPLE-analyses	(g) analysing the socio-cultural environment
(8) Diamond-model	(h) analysing competitors following a similar strategy

6. Match the examined type of environment with the method of analysis to be applied. More than one method can belong to one environment type. (7 points)

Environment	**Method of analysis**
A) Macro-environment	a) Porter's five forces model
B) Industry environment	b) Diamond-model

C) Micro-environment	c) PESTEL-analysis
	d) Strategic map
	e) STEEPLE-analysis
	f) Industry life-cycles model
	g) Customer value analysis

7. Match the types of environment below with the methods of analysis to be applied. (4 points)

The character of environmente	The method of analysis to be applied
A) a slowly changing, simple environment	a) experts' assessment
B) a quickly changing, complex environment	b) simulation
C) a quickly changing, simple environment	c) trend-extrapolation
D) a slowly changing, complex environment	d) scenario writing

8. What are the different types of environment called? Match the pairs. (4 points)

The name of environment	The character of environment
A) complex	a) a slowly changing, simple environment
B) dynamic	b) a quickly changing, complex environment
C) turbulent	c) a quickly changing, simple environment
D) static	d) a quickly changing, complex

9. Name the categories of the SWOT-analysis. Put the characteristics below into the right place. (8 points)

1. ………………………………….	2. …………………………..

3. …………………………………	4. …………………………..

a) a stable market position
b) inflation is predicted to decrease in the next year
d) the quality of raw materials deteriorates
e) small marketing-budgeting
f) more and more repairs under a guarantee or warranty
g) a strong, positive brand
h) sources for tendering can be expected in the industry

10. Name the categories of the SWOT-analysis. Put the characteristics below into the right place. (8 points)

1. ………………………………….	2. …………………………..
3. …………………………………	4. …………………………..

i) the increase of credit rates is expected
j) the sales of our strategic products exceed those of our main competitor's
k) narrow market capacity
l) the Japanese market is interested in the products of the industry
m) up-to-date quality-management system and trade mark certification
n) inappropriate liquidity

o) more and more cheap imitations appears on the market as a competitor of our strategic product

p) increasing demand on the part of training institution to place trainees at the business

11. Put the steps of the resource-based strategy view into the correct order. (7 points)

1. …
2. …
3. …
4. …
5. …

Selecting strategy
Identifying competency-gaps
Identifying the company's competences
Identifying the company's resources
Examining the income generating capabilities of the resources and competences

12. Match the examples with the resource-categories. (7 points)

1) Financial resource	a) purchased goods
2) Human resource	b) task-distribution
3) Physical resource	c) licence
4) Technological resource	d) relationship with the academy
5) Organisational resource	e) established consumers' opinions
6) Reputation	f) liquidity
7) Innovative resource	g) experience

13. Match the characteristics with the appropriate strategies. (7 points)

Characteristics	**Strategy**
(1) Low-cost strategy	a, the product is unique, therefore customers are willing to pay more for it

(2) Analysers	b, besides realizing yet achievable turnover, regulated withdrawal of capital
(3) Harvesting	c, as industrial structure has not been developed yet, the company can attempt to develop the rules itself
(4) Filling gaps of market	d, acquiring a certain kind of market segment and developing a strong position
(5) Developing industrial structure	e, the company appears with low prices and a wide range of products on the market
(6) Differentiation strategy	f, concentrate on the function which ensures successful operation and competitive advantage for the company
(7) Company-oriented strategy	g, besides maintaining the current position, new products and markets are planned

14. Match the relevant strategy with its definition. (4 points)

Strategy	**Definition**
(1) Differentiation	a) The company appears with a wide range of products produced at low budget and with low prices on the market even in more than one industry at a time.
(2) Low-cost strategy	b) If competitors underachieve in reaching the same segment of target market, then the basis of competitive strategy is to satisfy customer demand better.
(3) Cost leadership	c) If competitors underachieve in satisfying customers' needs, then a more optimal budgeting can provide competitive advantage for the business.
(4) Differentiation focus	d) The product the company offers is somehow unique, and therefore customers are willing to pay more for it.

15. Match the relevant strategy with its description. (4 points)

Strategy	Description
(1) Defenders	a) These participants are characterised by wide operating segments and a wide range of varied technologies, thus always seeking new innovations.
(2) Prospectors	b) These companies are not able to respond properly to the challenges of the environment.
(3) Analysers	c) In the narrow segment of market they are competitive and their primary goal is to maintain competiveness. Besides, in order to defend their market position, they make their production more efficient and apply more efficient organisational methods.
(4) Reactors	d) They strive to adapt flexibly to the challenges of the environment, but it is important for them to preserve the position that their company has already earned in the markets. Their main goal is growth within the segment available.

16. Which strategies are recommended for which industry life-cycle? Match the industry life-cycle and strategy. More than one strategy can belong to one industry-cycle. (3 points)

Character of industry life cycle	Environmental features
(1) Emerging industry	a) Sophisticated cost analysis
(2) Growth and maturity	b) Filling a gap in the market
(3) Declining industry	c) Harvesting
	d) Developing Shaping industry structure
	e) Shifting mobility barriers
	f) Technological innovation and production planning

17. Match the chapters of the plan with their contents. (7 points)

Chapter of plan	**Contents of chapter**
I. Introduction, general data	a) It should give a picture about the most important statements of the plan to those as well who do not want or are not able to read the detailed plan.
II. Executive summary	b) The characteristics of business operation (activities, departments, management, etc.) until now.
III. Company description	c) Contains information about the industry prospects and competitive situation.
IV. Environment description and industry characteristics	d) Describes which products must be developed or recalled from the market.
V.1. Description and planning of products, services	e) These data can partially be found in the certificate of incorporation and partly in official registration of the business.
V.2. Price policy	f) Describes what distribution channels are targeted by the company
V.3. Sales plan	g) Describes that on the basis of expenses and planned profit at what price the products must be sold.

18. Match the chapters of the plan with their contents. (7 points)

Chapter of plan	**Contents of chapter**
V.3. Sales	a) Plans the marketing-mix to be applied.
V.4. Promotion plan	b) Describes if redeploying of work force or taking on new employees are necessary.
VI. Functional, Operational plan	c) Describes what distribution channels are targeted by the company.
VII. Organisational or human resources plan	d) The reliability, the accuracy of the data, and the probability of the occurrence of the events must be examined for each company area.
VIII. Risk assessment and - plan	e) Often contains cash flow.
IX. Financial, financing plan	f) Trade companies typically have a sales plan.
X. Appendices	g) Preliminary agreements made and

	declarations of intent can get into this chapter.

19. Of the following requirements choose the ones that a good business plan must necessarily meet. (There are several good answers).
    1. It determines the job of management accurately.
    2. It should be encouraging for the ones concerned.
    3. It should give an ideal picture of the business.
    4. It should be realistic.
    5. It should be numerical.
    6. It should be flexible.
    7. It should be contradiction- free.
    8. It should make the job of the management easier.
    9. It should show how the company management should manage the profit.
    10. It should guide the relationship of the organisation and its partners.

20. Match the type of risk with its characteristics. (3 points)

Risk	**The characteristic of risk**
(1) Risky data	a) we have a full range of information about the circumstance
(2) Certain data	b) there isn't a full range of information about the circumstance available
(3) Uncertain data	c) there are only some uncertain data available

21. Match pairs (decisions related to operations) (7 points)

A) Manufacturing process	1) the quantity of products manufactured
B) Quality	2) is influenced by the labour force supply, closeness to suppliers, and customers
C) Capacity	3) know-how, patent, etc.
D) Scheduling	4) can be intermittent or repetitive
E) Technology	5) e.g. JIS

F) Stock piling	6) e.g. JIT
G) Location	7) actually what customers consider it to be like

22. Put in the right order (Six sigma). (5 points)

A – data analysis

C – controlling processes

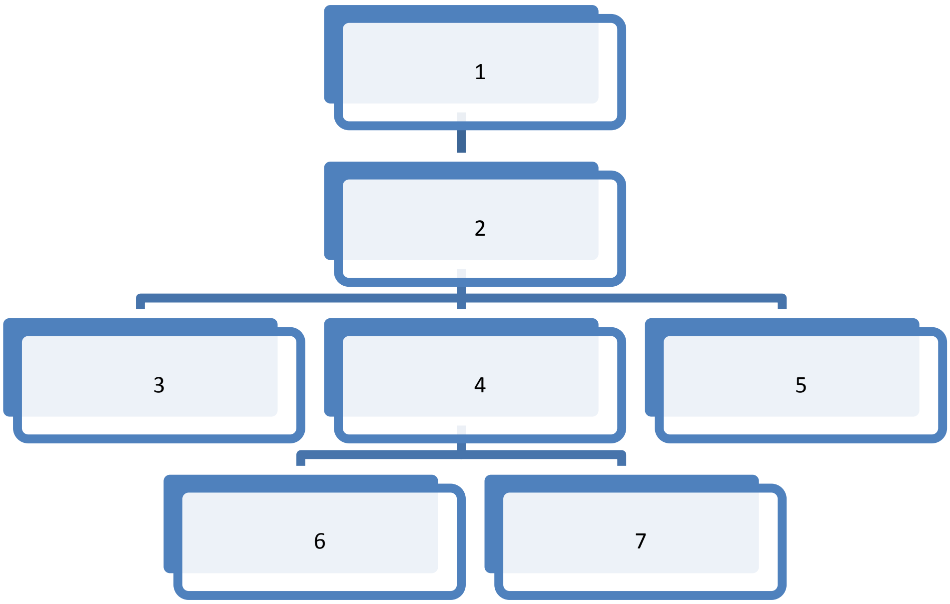
D – determining customers' expectations

I – improving processes

M – assessing the main aspects of the process

23. Put the given positions into the right box (the top-level managers). (7 points)

financial leader (CFO), operations manager, controller, Board of Directors, managing director (CEO), marketing manager, treasurer



24. Match pairs (financial report). (6 points)

A) balance sheet	1) indicates the cash inflows and cash out-flows
B) income statement	2) compares the firm's incomes and ex-penses

C) cash-flow statement	3) indicates the different assets of the firm
D) operating cash-flow	4) indicates the changes in the size and structure of the organisation's equity, borrowed loans and credits
E) cash-flow from investments	5) indicates the cash flows related to the business's long term-investments and changes in the finances resulting from them
F) cash-flow from financing activities	6) indicates the changes in finances generated by the company's normal business operations

25. Put the steps of marketing activities into the right order. (5 points)

A. Understanding customers' needs.
B. Taking over reward from the customer.
C. Developing a marketing programme.
D. Building customer- and partner relationships.
E. Developing a customer-oriented marketing strategy.

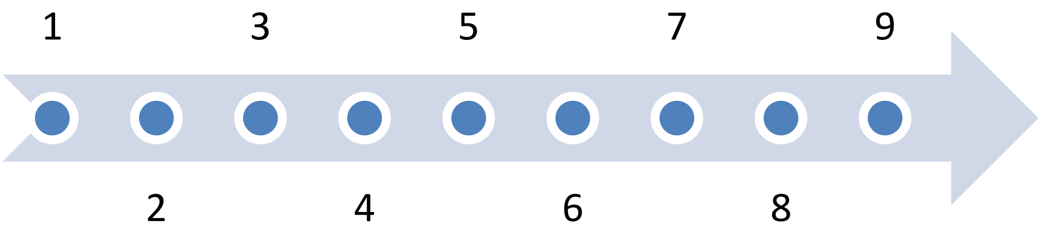
26. Match pairs (types of company orientation). (5 points)

A) customer-centred company	1) considering environmental, social and health related aspects
B) society-centred company	2) goods with excellent quality and performance
C) product-centred company	3) applying aggressive selling techniques
D) operations-centred company	4) meeting customers' need at the highest possible level
E) sales-oriented company	5) high productivity, low cost level, wide –ranged division

27. Put the following terms into the right group (marketing-mix). (10 points)
PR, variety, advertising, packaging, stock, brand name, warranty, credit possibilities, logistics, design

1) product: ………………………………………………………………………
2) price: …………………………………………………………………………
3) place:
………………………………………………………………………………
4) promotion:
………………………………………………………………………………

28. What is the correct order of developing new products? (9 points)
A) commercialisation
B) concept development
C) concept testing
D) marketing-strategy development
E) idea generation
F) idea screening
G) test marketing
H) product development
I) business analysis



29. Put the correct terms at the right level of the change pyramid. (5 points)

A) change tasks
B) change culture
C) change structure
D) change roles
E) change behaviour

30. Put the steps of strategy evaluation into the right order. (4 points)

analysing variances
taking corrective actions
measurement of performance
determining performance criteria

31. Match pairs (criteria of strategy evaluation). (4 points)

A) consistency	1) Strategy must ensure some kind of an advantage for the company.
B) feasibility	2) Strategy must not present mutually inconsistent goals.
C) consonance	3) Are there enough physical, intellectual and financial resources available?
D) competitive advantage	4) In strategy evaluation several tendencies as well as their impacts on each other must be examined.

32. Put the following terms into the right place in the table. (6 points)

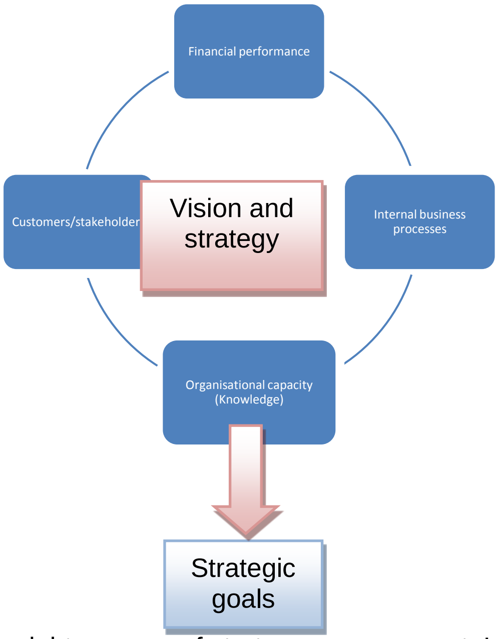
EPS, MVA, value-based management, Balanced Scorecard, EVA, ROI

	ACCORDING TO COMPLEXITY	
	Method based on one single metric	*Complex value increasing method*

ACCORDING TO FOCUS	*Focusing on company performance*		
	Focusing on value		

33. Put the key terms of the Balanced Scorecard method into the boxes. (5 points)

Solution: financial performance, internal business processes, organisational capacity, knowledge, customers/stakeholders



34. Determine the right process of strategy management. Use the following terms. (6 points)

goals, functional strategies, mission, strategy planning, strategy implementation, performance measurement

35. What are the steps of Lewin's change management model? (3 points)

………………………….
………………………….
………………………….

36. Put the steps of change management into the right order. (5 points)

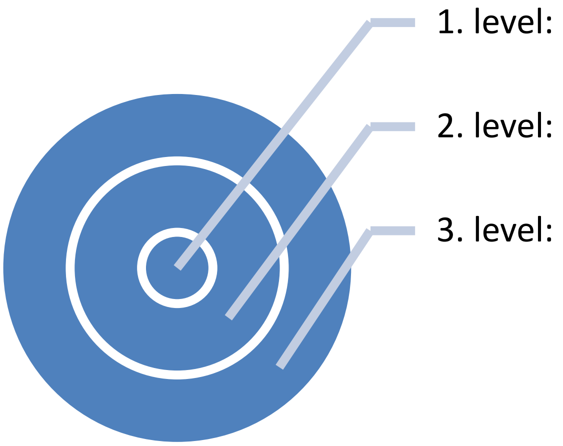
ability - to implement required skills and behaviours
awareness – recognising the need for change
desire – commitment to implementation
knowledge – having the knowledge necessary for change
reinforcement – to sustain results achieved by change

37. Match pairs for the characteristics of services. (4 points)

A) Heterogeneity
B) Intangibility
C) Perishability
D) Inseparability

1) Services are produced and consumed at the same time and that they cannot be separated from their providers.
2) Services greatly depend on who provides them as well as when, where and how they are provided.
3) A service cannot be seen, tasted, felt, heard or smelt (maximum its provider).
4) Services cannot be stored for later use or sale.

38. Put the elements of the product onion model into the figure.



39. Match pairs from the elements of 4P and 4C. (4 points)

promotion	customer
place	cost
price	communication
product	convenience

40. Match the pairs (company performance indicators) (4 points)

ROE	return on equity
ROA	return on investment
ROI	return on sales
ROS	return on assets