

CHAPTER 5 – STRATEGIC MANAGEMENT

Developing Business Strategy

Industry: a group of organizations/firms that share similar resource requirements (raw materials, labour, technology, customers).

Five-Forces Model – Analyzing External Environment

Allows us to systematically assess the industry environment.

- The relationships between the five forces determines attractiveness of the industry environment
- Used to make strategic decisions that leave the firm in the best position to defend itself

1. Threats of New Entrants

Two forms; new start-ups, or diversification of existing firms in other industries

New entrants bring new capacity, desire to gain market share, substantial resources, and capabilities which can *reduce profitability*. Incumbents need to create entry barriers;

- Economies of scale: spreading costs of production over the number of units produced → cost advantages
- Capital Requirements: extremely high for a new firm, threat of new entrants is reduced as the level of required capital increases
- Switching Costs: refers to the costs (monetary or psychological) associated with changing from one supplier to another from the buyer perspective. Threat of new entrants is greater when the switching costs of customers is minimal in that they can easily switch buying products from one firm to another
- Access to Distribution Channels: If incumbents control most of the distribution channels, potential entrants would find it difficult to distribute their products or services
- Cost Advantages Independent of Scale: Advantages independent of economic factors such as governmental policies, legal production (patents, trademarks), and proprietary products. These defer entries

2. Bargaining Power of Suppliers

Supplier power, the entities that provide raw materials, technologies, or skills to incumbents. Can demand better prices or threaten to reduce quality. This can occur depending on the *criticality of the resources*, the more critical, the more power lies with the supplier. Also the *number of suppliers available relative to the number of incumbents*, if there are less suppliers than incumbents, power lies with the supplier.

3. Bargaining Power of Buyers

Power held by entities that purchase from incumbents. Can demand lower prices, better quality, play incumbents against one another. Factors affecting buying power;

- Switching Costs: bargaining power of buyers increases as switching costs decrease
- Undifferentiated Products: allow buyers to find alternatives
- Importance of Incumbents' Products to Buyers: the more important/critical the products or services are, power of buyers diminishes.
- Number of Incumbents Relative to the Number of Buyers: power of buyers diminishes when there are few incumbents, since there are fewer alternatives to choose from

4. Threat of Substitutes

All firms in an industry often compete with other firms in different industries, where the firms provide substitute products or services with similar purposes. ex newspaper industry as a whole is threatened by radio and internet.

5. Rivalry Among Existing Firms

Can be intensified by the following factors;

- Lack of Differentiation or Switching Costs
- Numerous or Equally Balance Competitors: some firms may believe that they can initiate strategic action without being noticed, their action intensifies rivalry among incumbents. Rivalry tends to be highest when the firms are similar in size and resources, these firms often tend to target similar market niches and share similar resource requirements
- High Exit Barriers: refers to economic, strategic, and emotional factors that keep firms competing even though they may be earning low or negative returns on their investments (visible fixed costs, specialized assets, escalating commitment of management and governmental and social pressures)

Analyzing the Internal Environment

Jay Barney's **VRIO model** (value, rareness, imitability, organization)

Value: managers need to ask if their firm's resources and capabilities add any *value* to capture market share or enhance profitability, either through exploiting emerging opportunities or neutralizing threats.

Rareness: valuable resources and capabilities help firms survive, these resources and capabilities need to be rare (controlled by a small number of firms) to obtain a competitive advantage

Imitability: How long the advantage lasts depends on how quickly imitation could occur, need to create barriers to imitation so the degree of rareness and value of the resources and capabilities does not diminish.

Organization: firms need to be organized in effective and efficient ways to exploit their valuable, rare, and difficult-to-imitate resources and capabilities to maximize their potentials. This is critical to success.

If the firm does not achieve these four steps to ensuring a sustainable competitive advantage, it will have a *temporal competitive advantage*.

SWOT Analysis

The conclusion of the VRIO model and Five-forces model complement and supplement each other and can be summarized by SWOT Analysis (in combination with an analysis of the general external environment trends) → strategically use internal strengths in exploiting environmental opportunities, and neutralizing environmental threats while avoiding internal weaknesses

STRATEGIES

1. BUSINESS-LEVEL

Cost Leadership: gaining competitive advantage by reducing economic cost below that of all competitors. 3 sources; 1) *economies of scale* firms increase production volume to reduce marginal costs 2) *learning curve economies* firms can reduce MC by experience (learning by doing, and decreasing defects of productions or services) 3) *low cost access to factors of production*. These three sources could be easily imitated by competitors, but a combination of these three can make imitation difficult.

Advantages

- gives the firm the highest profit margins in the industry
- gives firm flexibility in response to pressures coming from five forces in industry environment

Product Differentiation: increasing perceived value of their products and services relative to that of other firms' (ex differentiate through product features, linkages between functions, location, product mix, links with other firms, and service). In order to achieve abnormal returns the firm needs to obtain a sustainable competitive advantage, need to create value that is rare and difficult to substitute or imitate. Advantage – good position to defend from pressures of five forces

Focus: target a particular buyer group, a segment of the product line, or the geographic market. By targeting a narrow market the firm is able to compete efficiently or effectively, and achieve differentiation by meeting the needs of the particular group or lower costs in serving the group.

2. CORPORATE-LEVEL

Two challenges; 1) which business or markets a firm should compete in 2) how these businesses or markets can be managed so they create synergy

Very difficult to grow in a single market in today's business world, globalization trend presents new market opportunities. Successfully managing *diversification* (a firm operating in multiple markets simultaneously) can give a firm enormous profitability and competitive advantage.

Motives for diversification;

Intra-firm dynamics – means to growth and managerial self interests, operating in a single market the firm may experience difficulties from saturation and intense competition, diversifying provides them with opportunities to sustain growth and increase revenue, may also benefit from *economies of scope* (cost savings from sharing activities)

Inter-firm dynamics – market power enhancement, response to competition and imitation → market power from increased market share or revenue can put firm in a better position to negotiate better prices and higher quality with suppliers due to higher volume of purchases, resulting in more leverage to compete against competitors. Also can be driven by firm imitation where highly successful firms have adopted the strategy, can result in failure and leave firms in dangerous positions.

Types of Diversification

Related diversification: expanding core business or markets into related businesses or markets. Usually involves horizontal integration across different business or market domains. Enables a firm to benefit from economies of scope, creates synergies, potentially greater revenues and market power, this could give the firm greater bargaining power over its suppliers and customers.

Unrelated diversification: provides little synergies, an extreme example is holding companies. A firm pursuing unrelated diversification tends to believe synergies are created through corporate office's management skills (in restructuring, and financial controls). When a particular business unit no longer provides financial returns it would be divested by the corporation in order to ensure the corporation's overall profitability.

Vertical integration: extension or expansion of firm value chain activities by integrating preceding or successive productive processes → Provides firms with benefits including securing raw materials or distribution channels, protecting and controlling valuable assets, reducing dependence on suppliers or distributors, more control over prices and quality, can increase profit margins, and gives firm strategic control in terms of its overall strategic direction. Risks → increasing administrative costs associated with managing a more complex set of activities, the increases in complexity can come from additional physical facilities, coordination between units, departments, or divisions, monitoring employees, etc. Vertical integration must be carefully managed.

Means to Achieving Diversification

Internal Development: ex Microsoft entering video game market through internal development of Xbox, Sony and Apple entering retail sector by opening their own stores. Through this process firms have complete control and solely capture the potential revenue and profitability. Two major disadvantages; 1) *significant resource commitment*, firm also requires to develop the capability, and may miss the opportunity by the time this is accomplished 2) bear alone the risk associated with diversification

Mergers and Acquisitions: *mergers*: two firms joining as one; *acquisitions*: acquiring the majority of shares from another firm, the acquired firm either becomes a division of the acquiring firm, or continues to operate independently or retain their brand or firm identity.

Strategic Alliances: two or more firms working together to achieve certain common goals. Three forms; 1) non-equity alliances: participating firms working together on contractual agreements 2) equity alliances: one firm has partial ownership in the other 3) joint ventures: two or more firms contributing to certain resources to form an independent entity. Advantages: quick access to new resources and capabilities contributed by alliance partners. Can be less costly, and less of a resource commitment, share risks associated with diversification. Disadvantages: share potential revenue and profits, partner selection to achieve their purposes 1) firm may misperceive the partners' resources and capabilities 2) partners may misrepresent their resources and capabilities 3) partners behave solely on their own interests.

Implementing Strategies

To implement strategies successfully, firms must have appropriate organizational designs (interactions that link together a firm's people, tasks, and technologies designed to ensure resources are most effectively used by employees to accomplish organizational goals).

Innovation → Organic

Cost Leader → Mechanistic

Quality Leader → Mechanistic

Small (Organic), Large (Mechanistic) – not true for all organizations.

Contingency theory – importance of context.

Static (Mechanistic), Dynamic (Organic)

Chapter 6 – The Competitive and Technological Environment

Given a long enough period of observation, almost all industries exhibit an inverted U-shaped growth pattern, with the number of the organizations rising initially up to the peak, and then declining as the industry ages.

The industry lifecycle model divides industry evolution into four distinct phases: introduction, growth, maturity, decline. According to the model, new industries tend to be highly fragmented and characterized by experimentation with novel technologies and business models. The lifecycle phase affects the degree of competition firms face, the type of organizational structure, the kind of strategy and the appropriate management approaches needed to survive and grow. The key success factors and sources of competitive advantage for firms are very different from one stage of lifecycle to the next.

The Lifecycle model shows how evolution affects industry structure and thus the forces of rivalry, potential entrants, and customer and supplier power and substitute products described in the porter model. Combined with the five forces framework it can provide managers with a more complete set of tools for analyzing and understanding the forces of competition.

THE INTRODUCTION PHASE: Organic Structure is needed

New industries emerge following innovations and changes that create opportunities for entrepreneurs. Some industries are the result of important breakthroughs such as biotechnology i.e. Technology or government regulation (e.g. satellite radio) The objective of this phase is to find the new industry's model and get it accepted and institutionalized.

The early years are characterized by uncertainty and risk (e.g. satellite communications)

Early entrants are small, entrepreneurial firms using technological innovation. Larger firms tend to lag smaller ones because there is a lot of risk and they have much more to lose, and because of their bureaucratic structures that inhibit their ability to move flexibly into new markets.

Firms are intensely focused on R & D and Competitors search for the industry's dominant design and standard. The type of customers willing to buy the product during the introductory stage are early adopters willing to pay a premium for the privilege of owning a product before everyone else. Price conscious customers will wait until the mature stage before buying. In the 1990's ventures planning to provide wireless telecommunications and broadband internet services through satellite networks were launched with much fanfare. Technical difficulties and financial troubles led to the demise of these ventures.

The Quest for Legitimacy:

The concept of organization legitimacy is a generalized perception that the actions of an entity are desirable, proper, or appropriate within some socially constructed system of norms, values, beliefs and

definitions. Sociopolitical legitimacy is the endorsement of an industry or activity by key stakeholders (government officials) and cognitive legitimacy is the level of public knowledge of a new industry and its conformity to established norms. Requiring legitimacy is a must in order to acquire from external stakeholder the resources needed. The lack of legitimacy will hinder their ability to recruit employees, obtain financial/material resources and sell products to customers. In entirely new industries the lack of legitimacy is even more pronounced. Stakeholders will question the viability of not just the venture but industry as a whole. Ex. An entrepreneur opening a restaurant will not need to convince the external stakeholders of the virtue of the restaurant as a business model but the someone starting a text message advertise firm will have to.

New industries seek legitimacy through collective action and institutional entrepreneurship

Despite increased competition, entry of large incumbent firms into new markets legitimizes the new industry like the entry of IBM into the PC industry.

Characteristics of the emergence phase: Low intra-industry rivalry, Intense R&D, Slow growth, Organic structures.

The widespread diffusion of a dominant design is a critical step in facilitating an industry's transition into the growth stage.

THE GROWTH PHASE: Organic Structure is needed

Growth stage begins with convergence around a dominant design or technical standard ex. Light bulb socket. Organizations whose approach does not conform to the dominant model either change or exit during a **shakeout (a large number of exits from the market as the aggregate output of industry increases. Weeds out the weaker competitors)** High growth and reduced uncertainty of the market attracts larger, established firms into the industry. Standardization of products and processes leads to economies of scale and less innovation as firms focus on sales and marketing to capture mkt share. The adoption of a dominant design greatly accelerates the growth rate of new markets. Ex. Automobiles after about 20 years of industry evolution. After standardization, process innovation and marketing become more important.

There are cases of firms pursuing the path of a proprietary standard not in line with the rest of the industry and remaining successful ex. Apple did not adhere to the Windows standard.

THE MATURITY PHASE: Mechanistic structure needed

Market growth begins to slow down; very little entry and rivalry becomes fierce among remaining firms. Market concentration increases with more exits and acquisitions. Products become commoditized and undifferentiated and innovations are incremental and process improvements. Successful firms are efficient and mechanistic. Shift in successful strategy and structure explains why few firms survive as industry leaders. A single share can mean millions of dollars in revenue so firms spend large amounts on advertising and sometimes enter into damaging price wars to lure customers from competition. Firms focus their innovative efforts on incremental improvements to products. New and improved versions.

Incremental innovations also provide opportunities to extend the lifecycle in order to delay the inevitable decline stage.

Entrepreneurial start-ups need to be innovative, dynamic and flexible. The organic structure with its decentralized approach, limited hierarchy and low formalization is better suited to the environment of the introduction and early growth phases. In a mature market where efficiency and cost-cutting matter more than innovation, the mechanistic structure, with its stricter rules, chain of command and narrow division of labor is more appropriate. Making the transition from one structure to the next is very difficult when organizations have been conditioned to behave a certain way. This is why few firms are able to remain industry leaders throughout the entire lifecycle.

THE DECLINE PHASE:

Industries begin to decline as a result of changes in:

- Demographics (e.g. baby food in the 1960s)
- Consumer needs/tastes (e.g. cigarettes)
- Technology (e.g. typewriters, VCRs)

Sales begin to fall and Competition becomes fierce in this stage as firms face tough choices regarding the future.

Firms can pursue different strategies to cope:

1. *Maintain industry leadership* – requires a firm to continue investing in marketing, and product development hoping competitors will eventually exit the market.
2. *Target niche markets* – find a specific segment of the industry that may not decline as rapidly as the rest so they can expect to possess some form of competitive advantage to discourage direct competition in the niche.
3. *Harvest profits*- squeeze as much remaining profit as possible from the industry by drastically reducing costs.
4. *Exit early*- recover some of their prior investments in the industry by exiting the market early in the decline stage phase, when assets may still be valuable to others.
5. *Consolidate* – acquiring at the best possible price the remaining industry players . allows acquirer to enhance its market power and generate economies of scale to make up for declining demand.

TECHNOLOGICAL FORCES

Types of Innovation

Technological innovation is a key driver of industry revolution. New innovations or technological discontinuities can create entirely new industries as automobiles and wireless phones have done, or seriously disrupt existing ones such as jet engines in the aircraft industry or digital cameras in the photography industry.

RADICAL or BREAKTHROUGH INNOVATIONS embody significantly new technical knowledge and represent a major departure from existing practices. Also known as DISCONTINUOUS INNOVATIONS, given that they build on a new base of knowledge that discontinues the previous technological regime. Ex. Digital cameras are discontinuous innovations in photography because they do not build on existing chemical photography technology.

INCREMENTAL INNOVATIONS, make relatively minor changes or adjustments to existing practices. Ex. Larger, higher resolution color screens on cell phones or making internal combustion engines in cars more fuel efficient.

Innovations that involve changes to the product's components but leave the overall configuration of the system relatively intact are called COMPONENT INNOVATIONS. Ex. Materials used in automobile bodies from steel to lighter aluminum composites.

Innovation that alters the system's architecture is an ARCHITECTURAL INNOVATION. Most arch innovations also require changes in the components. A laptop is an arch innovation given that it changes the standard configuration of a personal computer by making it portable.

Technological innovations that build on a firm's existing knowledge and skills in certain areas are called **competence enhancing**.

A **competence-destroying** innovation is one that renders obsolete an organization's technical skills and capabilities. Whether a technological discontinuity is competence enhancing or destroying is a matter of perspective. The same innovation can be competence enhancing in one organization and competence destroying in another pending the knowledge base. Ex. Electronic calculators were competence destroying for slide ruler makers but competence enhancing for firms like HP that developed its electronics capabilities.

The Evolution of Technology

Technological innovation leads to the "creative destruction" (Schumpeter, 1942) of industries – old technologies are 'swept away'

Abernathy and Utterback propose the technology lifecycle model to explain how rates of product and process innovation evolve during from the fluid, to transitional to specific phase of the technology.

The Abernathy-Utterback model states that technologies evolve from a fluid phase through a transitional phase to a specific phase. When a new tech is introduced, it is in a state of flux and there are a lot of technical/marketplace uncertainties. As industry grows a dominant design emerges and competition shifts from introducing new product features to meeting the needs of specific customers. A dominant design allows the standardization of parts and the optimization of organizational processes for volume and efficiency. In the specific phase, competition is based more on price than product features.

Punctuated equilibrium

Technological discontinuities tend to appear at rare and irregular intervals. They trigger an area of ferment, a period of substantial product-class variation that ends with the emergence of a dominant design. Once this design emerges future technical progress consists of incremental improvements elaborating the standard. The area of incremental change coincides with the maturity stage. Era of incremental change is a much longer period of relative stability. Long periods of incremental change are punctuated by technological discontinuities, hence the reference to a punctuated eq.

Technological Forecasting

The problem with the Abernathy-Utterback and Anderson-Tushman models is that they do not help in predicting when discontinuity will occur.

We can make more informed analyses of technological trajectories using S-CURVES. They explain the rate of advance of a technology. When a new tech emerges, progress starts off slowly, then increases very rapidly as technology is better understood and firms pour more efforts into R & D. as the physical limits of technology are reached and the returns to the engineering efforts start to decrease, the rate of technical progress begins to diminish. A new technology able to overcome the physical limits of the old one will then trigger a new S curve so that performance keeps improving with successive generations of S curves.

Moore's law - Moore predicted that the power and performance of microchips would double every 18 months. It has been fairly accurate and the rate of technical advance in microprocessor tech has in fact been exponential, based on the strategy of continually shrinking the size of the transistors on chips so electrons have less distance to travel. However as they get packed closer, they begin to overheat and performance suffers. In order for Intel and AMD to continue generating performance improvements in line with Moore's law a new technological discontinuity will have to replace the current miniaturization. Ex. Duo core processors.

Chapter 7 - The Global Environment

Globalization is a process involving the integration of world economies and world markets. The presence of trade blocs reflects the accelerating pace with which nations are integrating their economies ex. NAFTA, THE EU and APEC. Globalization is expanding the degree and forms of cross-border transactions among people, assets, goods and services. Globalization also refers to the growth in direct foreign investment in regions across the world and the shift towards economic interdependence. The process of generating one, single, world economic system.

A number of fundamental factors have encouraged the move to go global.

PULL FACTORS: reasons a business would gain from entering the international context.

- Engaging in global operations helps expand its markets, increased sales are typically the central aim behind a company's expansion into international markets.
- A significant portion of sales among the world's largest firms are generated from outside the home country. Ex. Starbucks expanding operations in Europe almost a decade ago was a pull factor.
- Obtaining Needed Resources: in order to obtain resources that are unavailable or too costly within domestic borders. Ex. Japanese businesses have located in China and Mexico where energy costs are not as high.

PUSH FACTORS: forces that act upon all businesses to create an environment where competing successfully means competing globally.

- *Force of Competition* – a business may find that it must compete against domestic and foreign competitors. A business may be pushed into becoming a global business by the simple fact that it is forced to compete with a foreign competitor. The drive to go global may be a response to a competitor's actions. Other domestic competitors may be expanding their markets overseas which creates additional incentive for the business to follow suit. **FIRST MOVER STRATEGY** – the benefits of being among the first to establish strong positions in important world markets. The longer a business waits the more difficulty they will have in establishing themselves in global markets.
- *Shift Toward Democracy* – among many societies that were formerly economically and politically repressed has contributed to the creation of new market opportunities. Ex. Russia and Poland who used to have totalitarian regimes have experienced this.
- *Reduction in Trade Barriers* – global activities have been growing at a faster rate than in the previous years in comparison to growth in domestic business. The most powerful source of influence encouraging increased int. business is the reduction in trade and investment restrictions. Ex. NAFTA removed trade barriers between US, Can and Mexico...
- *Improvements in technology* – advancements in tech have more efficiently facilitated cross-border transactions. Innovation in Info Tech and Transportation have made it increasingly easy to transfer information, products and capital around the world.

CHANNELS OF GLOBAL BUSINESS ACTIVITY

Exporting and Importing – In addition to selling goods or services to other countries, Canadian businesses may also purchase goods or services from foreign countries for resale to Canadians. Merchandise exports are tangible goods transferred out of the country and Merchandise import = tangible goods brought into the country. Same goes for services like banking and management services. Another type of service import/export can be the use of a company's assets including things like patents and trademarks. EXPORTING industry offers much additional profitable activity for businesses and lots of opportunities. THE US is our largest trading partner. Currently we export more of our manufacturing to the USA than we consume.

Outsourcing – hiring external organizations to conduct work in certain functions of the company ex. Payroll, accounting and legal work. The organization will typically retain its core functions. Nike outsources manufacturing to developing nations while focusing on the marketing of its product. This has been a source of controversy as Canadian jobs have been shipped abroad.

Licensing and Franchising – LICENSING is an agreement whereby the owner of a product or process is paid a fee or royalty from another company in return for granting permission to produce or distribute the product. Ex. A CAN company might grant a foreign company to produce its product. Companies that don't wish to set up actual production or marketing operations overseas can let the foreign business conduct these activities and simply collect royalties. FRANCHISING becomes a global activity when the franchises are scattered in different locations around the world. It involves drafting a contract between a supplier and a dealer that stipulates how the supplier's product or service will be sold. The franchisee is the dealer who is permitted to sell the goods/services if the franchiser.

Direct Investment in Foreign Operations – (FDI) involves the purchase of physical assets or an amount of ownership in a company from another country in order to gain a measure of management control. Capital can be invested in factories, inventories and capital goods + other assets. A direct investment can be done through acquisition of an already existing business in the host country or through a start-up built. If a suitable business already exists in the host country it may prove more efficient than starting up a business there from scratch.

Why would a Business engage in FDI? Controlling companies can obtain access to a larger market or needed resources via FDI. Although FDI increases in a country employment levels do not necessarily rise because of this increased investment... this is due to mergers that result in the consolidation and elimination of some common functions.

Joint Ventures / Strategic Alliances – a joint venture involves an arrangement between two or more companies from different countries to produce a product or service together or collaborate in the research development or marketing of this effort. This is also known as a strategic network. Ex. Telecom has formed strategic alliances with numerous foreign based organizations like Daewoo. Strategic alliances aim to extend or enhance the core competencies of the businesses involved and generate new market opportunities for all markets involved.

Mergers and Acquisitions – a Can. Company could actually merge with a foreign-owned company and create a new jointly owned enterprise that operates in at least two countries. Ex. Montreal based commercial printing business, was able to expand rapidly in Latin America largely through acquisitions and partnerships with local companies. Mergers occur because of the drive to obtain new markets, new knowledge and expertise in an industry. Achieving economies of scale may also be an influence (obtained when higher levels of output spread fixed costs over more units produced and reduce costs per unit).

Establishment of Subsidiaries – a business may choose to maintain total control of its product or service by either establishing a wholly owned subsidiary or by purchasing an existing firm in the host country. Acquisitions of local companies allow efficient entry into a market with already well-known products and distribution networks. Establishing a subsidiary from scratch in the host country may also be a viable option. Ex. Japanese car manufacturers set up operations in NA after there was an import quota placed on their cars. They were able to capture a larger market share. Benefits – if the foreign country is a high source of sales for the enterprise it makes sense to establish a presence in that country in order to be more responsive to local consumer needs. Among the risks is the threat of political instability.

THE MULTINATIONAL CORPORATION

- A global business is a business that engages directly in some form of international business activity (import/exporting and international production)
- A business that has direct investments in at least two different countries
- Generates products or services through its affiliates in two or more countries and manages from a global perspective.
- May also be referred to as global companies when they operate in myriad countries across the world.
- Very large organizations in terms of their relative role in the world setting... estimated that the 600 largest MNC's account for about one-quarter of the activity of the world's economies.
- Globally Integrated - integration through a central office, e.g. making products and services together, HP, Nestle,
- Multi Domestic - international subsidiaries operate relatively autonomously, e.g. IKEA, Coca-cola, Nortel. Canadian division will focus on its market and the U.S. division will focus on its market.

Who creates these organizations? Most MNCs have headquarters in the developed countries (the home country)... over half of them have headquarters in the USA. They maintain branch plants or subsidiaries in two or more foreign countries (host countries) they can be developed, developing or Third world countries. Among well-known Canadian MNC's are Bata Corp. and Bombardier, which has its head offices in Montreal but 90% of its sales are outside of Canada.

THE BORDERLESS CORPORATION

Refers to the increasing ability of MNC's to ignore international boundaries and set up business just about anywhere. This term points to the **blurring of boundaries** for business operations

Indicates that the **nationality** of the organization is unclear. Goods can be designed in one country, raw material obtained from a second country, manufactured in the third country and shipped to consumers in the fourth country. TOP MANAGEMENT can be composed of international members, reflecting the international composition of the organization. The headquarters of MNC's can be quite irrelevant. Ex. Nestle is headquartered in Switzerland, although fewer than 2.5% of its workforce are actually working in the home country. Nestle has manufacturing facilities in over 50 countries and owns suppliers and distributors all over the world.

Potential benefits of MNC's

- Encourages economic development
- Offers management expertise
- Introduces new technologies
- Provides financial support to underdeveloped regions of the world
- Creates employment
- Brings different countries together
- Facilitates global cooperation and worldwide economic development
- Encourages international trade through a company's access to different markets: It is relatively easy to produce goods in one country and distribute them in another country through a subsidiary.

Potential Threats

- MNC's do not have any particular allegiance or commitment to their host country
- Profits made by an MNC do not necessarily remain within the host country, may be transferred to other locations depending on where the MNC feels the funds are most needed
- Decision making may be highly centralized in the home country so that even though other functions are performed in the host country they don't necessarily include R & D and strategic planning.
- Difficulty in the ability to control and hold MNC's accountable can create serious ethical concerns for the host country.

International Trade: The purchase, sale or exchange of goods or services across countries.

The Logic of Trade: One fundamental argument is that since some countries can produce certain goods or services more efficiently than others, global efficiency and wealth can be improved through free trade. Consistent with this view is the belief that trade should be permitted to continue according to market forces and not artificially restricted through trade barriers. Freer trade would allow countries to trade as they deemed appropriate rather than trying to produce all goods domestically. Each country would specialize in producing those goods and services in which it maintains an absolute advantage. Free trade is based on the objective of open markets where a level playing field is created for businesses in one country to compete fairly against businesses in other countries and the aim reflects the fundamental principles of comparative advantage. Ex. It is inefficient for Canada to try and grow coffee beans or bananas, given the climate. Rather than

wasting effort and money, these items can be imported from countries more suited to such endeavors while Canadians can focus their efforts in areas where they can produce more efficiently. International trade has encouraged the development of free trade agreements / free trade areas but has also raised questions of protectionism.

Mercantilism:

The trade theory underlying economic thinking from the period ranging from about(1500-1800): encourages trade surpluses where more money is made from exporting goods than importing goods or services. Trade surpluses come about when a country's exports exceed its imports, more money is entering the country than leaving. This policy was popular in Europe. Countries implemented this mercantilism in a number of ways including imposing tariffs or quotas on imports, subsidize domestic businesses or colonize developing countries to gain access to raw materials. Colonies would also serve as markets for finished products. Trade between mercantilist and their colonies resulted in large profits, given that the colonies were paid very low wages for their raw materials and forced to pay high prices to purchase the final products. Mercantilist countries aimed to become as self-sufficient as possible with regard to domestic production of G&S.

Trade Protectionisms:

Protect a country's domestic economy and businesses through restriction on imports. Imports can be a threat to a country's business and economy:

1. Low-priced foreign goods that enter the country could compete with goods already produced here and take business away from domestic producers... loss of sales, jobs for domestic industries that are unable to compete with these lower-priced imports.
2. A Country that imports more than it exports will have a trade deficit which often results in more money flowing out of the country than flowing in.

Among the best known government responses to address these potential risks are the imposition of tariffs and import quotas.

- Tariffs – tax placed on goods entering a country. They raise the price of imported products discouraging domestic consumers from purchasing them.
- Quotas – limits the amount of product to be imported. They help ensure that domestic producers retain an adequate share of consumer demand for this product. Ex. In the 1980's the US and Canada negotiated deals with Japanese government to voluntarily restrict the number of vehicles they would export in the US and Can. Ironically this was short lived because Japanese automakers eventually built plants in US and Canada and achieved a greater market share of the NA market.

What's wrong with Mercantilism and protectionism?

Assumes that trade involves zero-sum gain and that the world's health is a fixed pie and a nation can only increase its share of the pie by forcing other nations to reduce their shares. The practice creates a one-way street of trade. A mercantilist country aims to maximize the goods/services it sells to other countries yet it expects to restrict the goods/services that these same countries attempt to sell to it. Even in the time of colonialism the policy was self-defeating: colonies that received little payment for their raw material exports could not accumulate sufficient wealth to afford the high-priced imports that the mercantilist offered.

PROMOTING INTERNATIONAL TRADE:

We have seen a gradual lifting of trade restrictions as part of the wave of globalization.

- One of the most ambitious programs designed to encourage free trade was established in 1948 with the founding of GATT (general agreement on tariffs and trade) 100 countries agreed to reduce tariff levels.
- **WTO (world trade org 1995)** – took over from GATT, to manage world trade agreements. Its mandate is to develop rules for world trade and discourage protectionist laws.
- **IMF (international monetary fund)** – provides short term aid (low-interest loans) to developing countries.
- **World Bank** – seeks to provide long-term low interest loans to third world nations for development.

Facilitating Global Business:

REGIONAL ECONOMIC INTEGRATION – means bringing different countries closer together by the reduction or elimination of obstacles to the international movement of capital, labour and products/services. A collection of countries within such an integrated region is typically referred to as a regional trading bloc. Countries integrate to maximize the benefits of international trade. Regional integration can occur at different levels of intensity:

1. **Free Trade Area:** removing subsidies & quotas for member countries but autonomy in selecting trade agreements with non-members, e.g. NAFTA, APEC
2. **Customs Union:** Free Trade Area but less freedom about interacting with non-members i.e. common policy e.g. Mercosur
3. **Common Market:** a free flow of labor and capital across borders. e.g. EU
4. **Economic Union** – builds on the previous three forms and in addition involves co-ordination of economic policies including high levels of integration, EU?

European Union: this common market consists of 25 European countries with a single flow of currency, a free flow of money, people, products and services within its member countries. One of Canada's most important trading partners. THE EU can be a double edged sword for non-members as it can generate protectionist policies for its members to bar the US and Japan from entry and on

the other hand THE EU can also create opportunities for non-members. Ex. A number of US companies have chosen to engage in joint ventures with the European based companies as a means of obtaining some kind of presence in the European market.

Asian Trading Bloc: region of growing importance to Canada and has a total population of about 2 billion.

ASEAN – region of growing importance to Canada. The Association of South-East Asian Nations was established in 1967 and became the first major free-trade bloc in Asia. Its aim was to promote greater cooperation in areas such as industry and trade among the members. The process of creating a trading bloc has been slower in Asia partly because, unlike NAFTA and the EU, there is a very wide disparity between the economic infrastructures and the GDP's of Japan, South Korea and China.

APEC – Asia-Pacific Economic Cooperation. Viewed as a significant economic force, given that its members generate over 50% of the global output and 50% of its merchandise trade. Includes three of the traditionally largest economies, USA, China and Japan. NAFTA was included in APEC largely as a means to forge stronger economic links between North America and Asia. Canada's central aim in joining APEC was to expand trade opportunities with the region. The region has a pop. Of 2 billion and is a huge market for Canadian exports. This agreement allows Canada to pursue similar levels of access it has to United States to other major regions such as Asia.

NAFTA – FTA between CAN and USA in 1989... and NAFTA between CAN, USA and Mexico in 1994.

- To Reduce/eliminate tariff barriers on almost all goods and services traded
- To facilitate cross-country investment
- To establish rules for government subsidies
- To establish universal rules for health, safety & the environment
- To provide a common market among members

ADVOCATES of FREE TRADE SAY:

- NAFTA achieved its most fundamental objective: to increase the level of trade between Canada and the USA. CAN & US trade increased by 75% since the establishment of the FTA. The USA continues to be Canada's major trading partner, accounting for almost 80% of Canada's total trade.
- Increases levels of trade between Canada, US & Mexico. Transforms all three economies
- Canada's merchandise trade with the US increased by 80% in the first five years of NAFTA and Canada's trade with Mexico increased by 65%.
- NAFTA has helped transform the three economies while creating synergies that go far beyond economic prosperity. There is little doubt that on the whole, the agreement produced real net

benefits for workers and consumers of the three countries. US, CAN and MEXICO has more than doubled since the agreement.

CRITICS of Free Trade Say:

- Trade increases have historically been due to low value of Canadian dollar (but this may change with recent increase in value against the US dollar). Canada still relies on exporting raw materials, we are now too dependent on the US – must expand trading partnerships. There have not been any improvements in the quality or nature of Canada's export patterns. Higher tech exports need to be generated so that we can become stronger in more valuable types of exports and engage in more R&D.

NAFTA's Impact on Canadian Employment and Business:

Pro (advocates say) - Improves domestic markets through increased competition to improve efficiency & standards. Encourages countries to abort inefficient operations and focus on the relatively stronger commodities or services in which they have a competitive advantage.

Con (critics say) - Competition may be too strong – forcing bankruptcy, job losses through closures and cheaper productivity/labour outside of Canada. Ex. Many manufacturing jobs are lost to Mexico given the country's relatively cheaper labor.

NAFTA's Impact on Canadian Culture:

Pro (advocates say) - Doesn't impact Canadian culture (not signing away Canada's heritage more than the EU community forced European nations to lose their individual cultures), cultural exports \$4.5 bn and big market in music royalties.

Cons (critics say) - May destroy Canadian culture, Canada may become a 'subsidiary of USA, competition from American media affects Canadian cultural capital.

NAFTA's Impact on Canadian Competitiveness and the Canadian Consumer

Pro (Advocates say) - more exposure to competition encourages Canadian businesses to become more competitive, more choice for consumers, Less expensive goods for consumers, extends resource networks, further market opportunities. Forces Canada to recognize and manage relationship with the US. Gives Canada greater access to selling goods and services to this market through the reduction of trade barriers.

Con (critics say) – NAFTA has not encouraged increased in productivity, Canadians unable to match US productivity. NAFTA has not reduced the productivity gap between CAN and USA. Our record of exports has come about largely because of relatively low value of the Canadian Dollar. Higher Can dollar might result in decreased exports.

The dilemma of NAFTA for members is continues where critics suggest its primary beneficiaries are large corporations rather than individuals. The concern that the rights of corporations are paramount in NAFTA is clearly illustrated in the growing number of lawsuits aimed at the governments accused of discriminating against foreign owned corporations. A case in point is that of UPS vs. Canadian Gov. This controversy stemmed from one section of NAFTA legislation referred to as Chp. 11 permitting foreign corps to sue federal govts for compensation if that government interferes with profits of the foreign corp.

Chapter 8 Notes – The Political System

Historically the Gov has played an important role in the Canadian Economy. Our system has been described as a MIXED system. While we possess a capitalist economy, government nonetheless plays an important role.

Business Enterprise System determines the following:

1. What goods and services are produced and distributed to society
2. How the goods and services are produced and distributed to society

These decisions might be made by businesses, government or a combination of the two.

It is necessary to understand the nature of capitalist economic systems in order to comprehend the Canadian business enterprise system.

CAPITALISM is based on the following principles:

1. Rights of the individual: Individuals take precedence in society as opposed to institutions and overall society. Individuals have every right to pursue their own self-interest. (In Canada there are limits placed on individual rights to pursue self-interest ex. Gov regulation enforces rules that affect how businesses conduct their affairs.
2. Rights of the private party: Individuals have the right to own land, labour and capital. (In Canada the gov has intervened because there has been an uneven distribution of wealth i.e. taxes)
3. Competition: Capitalism advocates competition. This will ensure business provides the goods and services required by society at a fair cost.
4. The role of government: Laissez faire meaning “let people do as they choose”. Minimal gov interference in the business enterprise system. “free enterprise system”

The polar extreme of capitalism is another economic system referred to as COMMUNISM. It places the responsibility for the allocation of resources in the hands of the government.

GOVERNMENT AS GUARDIAN OF SOCIETY

The Tax collector role: at the federal, provincial and local level. There are revenue and regulatory taxes.

The intent of revenue taxes is to collect money in order to help fund gov services and programs. They include:

Individual income taxes (govs largest source of income): levied on the income of individuals.

Corporate taxes: (2nd largest source of income): corporations are taxed on their net profits

Property tax: used to fund the operating costs of the municipal government and the services that it generates.

Sales tax: paid through retail stores.

REGULATORY TAXES: aimed at controlling the use of specific goods and services.

Excise taxes - applied to goods and services the gov desires to restrict, such as products deemed to be harmful.

Tariffs and duties: taxes on imported goods increase the production of local producers... raise prices of imported goods.

THE BUSINESS OWNER ROLE: CROWN CORPORATIONS

A crown corporation is an org accountable through a minister to parliament for its operations. (CBC, Canada Post)

- To implement policy that includes protecting or safeguarding national interests. Ex. Air Canada and Petro-Canada facilitated gov policy in the area of cross-Canada transport and Canadian ownership in the domestic oil industry.
- To protect industries deemed to be vital to the economy. Ex. The CRBC was established to administer a national broadcasting service in order to prevent Canadian broadcasting becoming inundated with material from the States.
- To provide special services that could not otherwise be made available by private business. Ex. Trans Can Airlines was established in 1930s after observing no private business was willing or able to provide domestic air services. Another ex. Is BANK OF CANADA which was established to serve as a control agent and develop monetary policy.
- To nationalize industries that were considered to be natural monopolies including the generation and distribution of electricity. Ex. Private sector too small to undertake the creation of a national supply electricity grid.

LCBO is a provincial crown corp in the sense that it is owned by the province of Ontario.

THE REGULATOR ROLE:

Government economic regulation – the imposition of constraints backed by the authority of a government that are intended to modify the economic behavior in the private sector significantly. Regulation focused on consumer protection, environmental protection, nature of competition. Ex. The food and drug act designed to protect the public from potential risks to health. The Hazardous Products act serves to protect public safety by banning products considered dangerous. Ecological regulations protect the environment ex. The Environment contaminants act, regulates the limit of dangerous by-products of industrial production that can be harmful to individual's health.

Imperfect Competition – occurs when fewer than the optimal number of competitors exist to ensure fair pricing and distribution of goods and services at the highest quality. The presence of imperfect competition suggest the need for gov involvement. Businesses that are not worries about competition are also not worries about innovating, managing their operations at peak efficiency, providing

competitive prices and improving their products and services. Consumers will be forced to accept those products. This leads to a less efficient use of society's resources, particularly compared to perfect competition. THE MARKET itself will not necessarily guarantee the best use of resources to generate the optimal mix of products for consumers at fair prices hence the need for gov intervention.

The Public Interest:

One of the central obj. of gov regulation is to protect the public interest through regulations. Ex. Canadian Transport Commission which judges route and rate applications for commercial air and railway companies. CRTC regulates the telecommunications industry. The Gov has established a competition policy to control the nature of competition in the business sector. We have gov regulation in the area of public utilities such as an electric power company or a telephone company. The competition Act 1986.

GUARDIAN OF THE PRIVATE BUSINESS SECTOR:

Gov assistance to Private business - we have a long history of government involvement in businesses in the sense of promoting and protecting our industries. Ex. Tariff and non-tariff barriers on imported goods designed to protect our domestic business by making foreign goods more expensive relative to Canadian goods. A large portion of Canada's industry development is due to protectionism through tariffs. INCENTIVE PROGRAMS were established to encourage managers to conduct business desired by the gov. ex. Invest in new product development, greater export activities and locate to an underdeveloped region. In return they will receive government financial support or reward. Canadian gov has also provided financial incentives in an effort to dissuade companies from moving their operations outside of Canada.

Among better known of gov assistance to a business occurred in 1980's when both Canada and the US governments provided a loan guarantee to banks of over 1 billion dollars in an effort to prevent the Chrysler corp from bankruptcy.

Bailout: one-time financial assistance to combat significant troubles that a business may be experiencing. Ex. Algoma steel in 1992... more recently the government of US and GM.

Subsidies: cash payments, low interest loans or potentially reduced taxes intended to assist domestic industry to compete against foreign businesses. Ex. e.g. Federal and Ontario government put up one-sixth of GM's beacon project in Canada.

One central argument against subsidies, business should be required to manage their own costs without external help or handouts from the government. This is a part of the requirement of fair competition. It is argued that consumers essentially pay for these subsidies as the government collects revenues through various taxes. The SECOND argument is that subsidies constitute a form of trade barrier just like tariffs and they create unfair competition.

WHY SHOULD GOVERNMENT PLAY THE ROLE OF GUARDIAN OF BUSINESS IN THE GLOBAL CONTEXT?

1. **Nurturing Young Industries:** The infant-industry argument asserts that the government should help a young industry grow and develop by ensuring it maintains a dominant share of the domestic market until it is mature enough to compete against foreign competition. Infant industry may be less competitive because of initially high output costs, however with maturity the production will become more efficient and protection will no longer be necessary.

 - Such protection can discourage domestic industry from increasing competitiveness and engaging in innovation.
 - **Not all Canadian parties want the Canadian steel industry to receive this kind of protection from foreign rivals because they want the lowest cost supplier to be accessible** and don't appreciate the protection of infant industry if it comes at a cost blocking access to cheaper foreign goods.
2. **Encouraging direct foreign investment:** the action of reducing foreign imports may result in the foreign business directly investing in the target country instead. It can set up business in the target country and gain access to their consumer market. From the domestic country's viewpoint this may be desirable if it increases job opps.
3. **Maintaining a Favourable Balance of Trade:** Gov may seek to influence the relative status of exports and imports to avoid running a trade deficit. Traditionally gov's intervened to ensure a trade surplus by imposing tariffs and quotas.
4. **Protecting domestic business from unfair competition:** foreign competitors can offer their products at extremely low prices as a means of monopolizing their share of the target market. Domestic producers could potentially be driven out of business and be replaced by the foreign imports. A foreign competitor who manages to export products at such a low price may be accused of DUMPING. Steel companies have been among the most avid users of anti-dumping legislation in Canada and the US. Dofasco Inc. lodged a dumping complaint against steel mills against Asia and South America.
5. **Maintaining adequate levels of domestic employment:** Gov is responsible for keeping the unemployment rate low. Imports that come to dominate an industry threaten domestic industries to go bankrupt. Traditionally the gov has battled this with tariffs and quotas. However protectionist policies are not compatible with the sentiments of free trade, and thus governments are sometimes placed in the unenviable position of balancing the needs of the domestic economy with the need to honour the rules governing global business.
6. **Offering Subsidies to Compete Globally:** helping domestic industries deal with global competition. Recently the WTO has been involved in many international disputes regarding whether a local government has given its domestic industry an unfair advantage through some form of subsidy. People argue that competitive industries should be able to absorb such costs themselves rather than relying on gov handout. The lumber dispute is an example of the difficulty in establishing the degree of which gov should aid business in the global context.

DEREGULATION: involves a reduction in the number of laws or regulations affecting business activity. Recently deregulation in the Canadian economy has accelerated in industry sectors such as transportation, telecommunications, financial services and energy services. For telecommunications deregulations has created an increased level of competition in overseas calling, local wireless etc.

In a number of countries we have witnessed economic deregulation among many industries, including airlines, trucking, railroads. At the same time, there has been an increase in regulations that are intended to govern areas like healthcare and the environment.

Regulation is aimed at correcting market failures and inequities that may arise of a variety of reasons including insufficient competition. However just as the market fails so can the gov policy of deregulation.

Potential Benefits:

- Increase competition arising from the reduction of regulations that have formerly restricted the entry of new competitors.

Potential Risk:

- The risk to consumers of exploitation. Ex. Reduction in quality of product or services, increase in consumer fees or price increases as a result of the reduction in laws governing their operation.

US based studies has offered strong support for the benefits of deregulation among a variety of sectors (railway, airline, telecommunications) the airline industry managed to reduce costs by 25% in the period following deregulation.

By 1996, long distance phone rates in the US had dropped by more than 70%. Deregulation encouraged much more innovation as reflected in the emergence of such profitable services as voice messaging.

It is interesting to note that the concept of cellular phone was discussed in 1950s and the technology had become available by the 1970s yet the FCC did not issue license until 1983 – a perfect example of the inhibiting effect of regulations on innovation.

1. **Deregulation in the transportation industry:** prior to the Motor Vehicle Transport Act, anyone wanting to enter the trucking business was required to appear before the provincial licensing board and prove there was a public need for their service in order to get a license for their truck. The new law only requires them to present proof that they are insurable and pass some minimal safety criteria. This resulted in more truckers entering the industry. Shippers gained from a wider choice of trucking services and more competitive rates. Consumers also benefited from reduced costs. Resulted in more efficient, value priced trucker eager to customize to shipper's needs. HOWEVERm some trucking companies have been unable to compete effectively and gone bankrupt, resulting in loss of hundreds of jobs. Reducing regulations welcomed more

entrants from the US who had lower operating costs and put more pressure on existing Canadian companies.

2. **Deregulation in the Insurance and Banking Industry:** deregulation permitted banks to enter the brokerage business and allowed them to sell insurance. Banks have long served as the perfect example for an industry with inadequate competition requiring rigorous gov regulation. Recent pressure exerted on the gov by banks to allow them to merge was faced with public fear of creating a greater monopoly situation. On the other hand there has been an opposite sentiment with regard to allowing banks to expand their services into the insurance industry because the current insurance distribution system fail to meet the requirements of the Canadian consumer. This would allow lower-income Canadians to obtain proper coverage. This tactic has worked in France where banks are allowed to sell insurance. The average expense ratio for bank insurance policies is under 5% compared to 14% for other companies selling insurance.
3. **Deregulation in the Airline Industry:** The National Transportation Act in 1988 eliminated many restrictions in the airline industry like restrictions related to routes, frequency of flights etc. airline could now offer any combination of scheduled and chartered services on their current routes and were no longer restricted in offering discounts. Made it easier for new players to enter the industry and allowed existing airline greater ease in expanding routes and increasing/reducing fares. Open Skies agreement permitted Canada-U.S. airlines to fly across the border on any routes they think will be profitable. The Can gov initiated deregulation because it felt that Canadian companies needed to learn how to compete internationally. CONVERSELY the positive affects of deregulation do not appear to have materialized in the Canadian airline industry. By the latter part of the 90's still only two airlines remained as dominant competitors in the industry. By 1999 Air Canada dominated the industry, after acquiring Canadian airlines. In 2000 The Ministry of Transport announced some degree of re-regulation. Air Canada once a Crown Corp was privatized in the 80s to improve efficiency. Ironically those same inefficiencies came back because of the power of private ownership in a monopoly situation.
4. **Deregulation in the Electricity Industry:** traditionally electricity costs have been much higher in Europe than NA. Deregulation helped drop the cost in these regions because it welcomed more competition forcing power companies to become more efficient and offer better customer service. The Canadian Gov also deregulated the industry in Alberta 1995. Mixed reactions. Some saying the purchase of electricity has become more complex. Those opposed to deregulation believe that public ownership should continue for essential services to ensure all members of society will be guaranteed access to the same service at a reasonable price.

PRIVATIZATION – divesting of government involvement in the operation, management and ownership of activities. Transfer of activities and functions from the gov to the private sector. Ex. Selling a Crown Corp to the private sector (Air Canada, TeleGlobe Canada Inc) It can also include contracting gov jobs to private firms like garbage collections.

Why Do Governments Privatize?

Belief in the power of competition as a control mechanism: Privatization of a state-owned monopoly will open an industry to competition and, consequently, encourage innovation, growth and efficiency.

Belief that private business can operate more efficiently: transferring the management of organizations to the private sector will result in increased productivity. Many believe that it is difficult for gov-owned enterprises to reconcile the social goals of the enterprise with the economic efficiency goals that must be a concern of any business.

No longer need public involvement in certain areas: Air Canada was established as a crown corp at a time when no private company had the resources to develop a transnational airline. In more recent times there are both domestic and international airlines more than capable of conducting such business and there is little need for gov ownership.

Financial Benefits from selling government owned assets: The money can be used on other more needed areas. Can be used to reduce government deficit and attract foreign capital. Ex. 17 billion was raised between 1990 and 1995 through privatization of two power generating companies in the UK.

CHALLENGES OF GOING PRIVATE

Stakeholders and objectives: The objectives of privatization are not held equally by all parties. The objectives of various stakeholder in privatization of a crown corp maybe conflicting. Consider the stakeholders affected by privatization of public utilities, government owners, creditors, future stakeholders of the organization, the taxpayers etc.

Employees objectives: Objective of privatization could all be considered objectives of the government owners but some may conflict with the elements of the enterprise itself. Ex. After the initiation of the privatization plan for Ontario Hydro, the senior manager was also agreeable to the province's plan for privatization. However within Hydro there has been much disagreement – culminating in a number of strikes by employees opposed to the government plans.

The Public's Objectives: another possible conflict is between the objectives cited and the public's concern for their protection. In the case of Ontario Hydro some citizens are concerned that private competitors may be less likely to serve the public's interests than a government owned enterprise and that privatization will bring higher rates and safety concerns. Foreign ownership is another issue. There were no foreign ownership restrictions placed on the privatization of Canadian National Railways and 40% of the share issue was sold outside of Canada. Critics felt this sale left too much power out of Canadian hands, and there was some question whether the newly controlled enterprise would keep Canadian interests high on their agenda.

Simply transferring ownership to the private sector does not guarantee efficiency gains. Ironically, the technical responsibilities of the government may increase after privatization because governments are shifting from owning and managing individual companies to potentially regulating an entire sector of the economy. Ex. Transfer ownership of natural monopolies like electricity or gas utilities.

Chapter 9 – Managing a Changing Environment

1. Consider the forces encouraging change in organizations.

Organizations can attempt to focus on any of the internal forces as a target for change:

Strategy: They can change their strategic direction to compete effectively

Structure: This can include re-engineering, downsizing or going virtual

People: Getting employees to adopt different work approaches than in the past, a major challenge is to ensure employees accept and adapt to change.

Economic Changes: Is the economy strong or weak? Organizations must adapt to changing economic conditions. Downsizings are more likely to occur in lean times. Lifetime employment is a thing of the past. Temporary work arrangements have become much more common. Flattening of many organizations have substituted horizontal career movement for the lateral vertical movement, so that you might move around an organization into different areas rather than directly up.

Competitive: Competition both foreign and domestic has demanded acceleration in innovation among firms. To compete effectively organizations must continually create new and better methods of serving customers. Globalization has opened up larger markets for businesses and facilitated much higher levels of competition.

Technological: Can be a double-edged sword for members of the workforce bringing both benefits and threats. Benefits include the ability to gain more flexibility in work arrangements such as the practice of telework. Threats include the jobs technology has rendered obsolete like bank tellers for bank machines.

Legal/Political: Deregulation and Privatization are very important in determining business strategy. The legal environment of a business can dictate changes in how it competes, as well as what services it offers and how they are to be offered. In the workplace we have witnessed an increasing emphasis on organizational justice on how employees are treated.

Societal: Consumer tastes change. Aging population suggest greater emphasis needs to be placed on industries like healthcare. Moving away from high job specialization where the task is broken down to its simplest form to demand employees to be multi-skilled in order to handle more challenging enriched work.

Global Changes: Globalization has been among the most pervasive forces affecting business all over the world. Tremendous growth of borderless organizations. Goods can be designed in one country, raw material in another and manufactured in a third country. Employees and communities were once critical factors in a companies long-term strategic decisions. Moving factories and jobs to another area of the country was unthinkable but now thousands are moving if it is cost efficient and maximized their return on investment.

Why do organizations resist change?

They are designed to produce goods and services in the most efficient manner, so that this efficiency can be reproduced on a daily basis. We learn how to do a job best and then we put mechanisms into place that ensure we can reliably reproduce this performance. This involves ensuring organizational stability in its operations. Changes to core structural features disrupt the organizations routines and can compromise its reliability and accountability.

How our organizations are designed is still being led by one dominant and traditional view... when it comes to organizations we still think in terms of machine bureaucracy. Understanding organizations as 'machines' enables us to see why they might be resistant to change. Bureaucracies have rigid rules and procedures in place which can create resistance to change. Although they allow for control and some level of security and consistency this can limit creativity and innovation.

The machine bureaucratic mentality stems from an irrational need for control. Any preoccupation with control to the degree that it emphasizes the machine bureaucracy over other forms tends to eventually become too rigid to adapt to change.

- Fear of the unknown
- Habit
- Don't see the need for change
- Threats to social relationships
- Economic insecurity

2. Understanding types of change / Theory E and O

Any organization must comprehend the nature of the change that it is attempting to undergo

Developmental change: Improves on what the business is currently doing, rather than creating something new. Improvement of existing skills, processes and methods. Examples are increasing sales or quality of goods.

Transitional change: This replaces what already exists with something completely new and requires the organization to depart from the old methods of operating while the new state is being established. Examples include mergers, acquisitions and creation of new products and services.

Transformational change: Far more challenging compared to other types of change. Future outcomes are uncertain but the organization and employees embark on a period of widespread change. Final state is determined through trial and error as new information is gathered. New mindsets and behaviors are required to adapt to this transformed state.

Whether it is the presence of new competitors new technologies or changes to any other forces facing business, organization respond with a variety of programs like structural change (mergers), Cost cutting (eliminating non-essential activities), Process Change (re-engineering), Cultural change (change relationship between management and employees)

THEORY E – has as its purpose the creation of economic value often expressed as shareholder value. Its focus is on formal structure and systems.

The central goal of this approach to change is maximizing shareholder value. Achieves this goal by making changes to organizational structure and systems. Emanates from the highest levels of an organization making it top driven. Mechanisms employed to achieve such change includes performance bonuses, personnel reduction and strategic restructuring of business units.

A perfect example of theory e change can be seen in the changes implemented by Scott Paper. A decade ago the CEO embarked on a series of changes. His main objective was to increase shareholder value by 200%.

THEORY O – its purpose is the development of the organizations human capability to implement strategy and to learn from actions taken about effectiveness of the changes made.

The central goal of Theory O is to develop organizational capabilities. Focus is on developing an organization culture that supports learning and high performance employee population. The planning for this type of change is emergent and participative rather than top-driven. The mechanisms employed to facilitate such change include flatter structure, increased bonds between organization and employees and employee commitment to change.

An example of theory O change involves the case of Champion International. In response to the poor performance CEO Andrew S. initiated an organizational change effort aimed at altering the culture and behavior of management, unions and worker.

3. TRANSFORMATIONAL CHANGE: examples from the IBM case

1 – Understanding the forces for change: at a time when the external marketplace was changing rapidly IBM had not realized its customers, competitors and technology had changed nor had it adapted to meet those changes. Gestner says that IBM's dominant position had created a self-contained, self-sustaining world for the company however in the early 90's it woke up and found itself close to bankruptcy. Gestner who was hired as a broad-based leader and change agent had to quickly asses and react to the rapidly changing external environment. After learning about IBM, the IT industry and external business environment he quickly learned that IBM had lost touch with the outside world. His advantage over previous leaders was that he was from the outside and had been one of IBM's formal customers, therefore he had first hand knowledge of their lack of customer focus.

2- The Change and Vision Implementation: Gestner had to develop and implement a program that would be accepted and adopted by stakeholders. Restructuring the organization can be relatively easy to having to change the corporate culture and establishing strategies for the new business environment. making change acceptable to all stakeholders, creating a shared vision for the future, strong leadership, separate from the past, create a sense of urgency, COMMUNICATE and involve people, be honest, reinforce and institutionalize change.

3 – The Need for Cultural Change:

Traditions ran deep at IBM and the company was known as much for its culture as it was for its products. Historically it had been a paternalistic family oriented company, providing its employees with generous compensations and benefits packages, lifelong employment and plenty of opportunities for advancement. There are two ways to change psychological contract (the set of implicit assumptions that underlie expectations of employees with regard to their employment status.) 1) accommodation: modify or alter the terms within the existing contract so that people feel the old deal continues despite changes OR 2) transformation: radical change that replaces the old mindset with new ones.

At IBM the psychological contract was transformed by Gestner's predecessor by laying off tens of thousands of employees and capping off future health benefits. Gestner also implement a pay for performance compensation program. Changing the culture from one of entitlement to one of accountability is a starting point for making a successful change.

4- Leading Change Through Communication - Gestner's communication and leadership skills were the most contributing factors in IBM's transformation. He expressed his passion about leading the company into a new era and visibly demonstrated that he was committed to change and ready to face challenges along the way with the rest of his leadership team. The most effective organizations are those that communicate openly, honestly and consistently. Gestner appointed himself to chief communicator, matched his words to his actions, put emphasis on face to face communications, informed employees of the crisis IBM was experiencing otherwise they would operate in the same manner and helped employees understand their roles and allowed them to formulate their own feelings and opinions.

5 – Reinforcing Change: plans must be reviewed regularly and become the driving force behind everything the company does. Translating strategies into action programs and measuring their results with quantifiable measures and holding people accountable for them. Must also target opinion leaders and those who are resistance to change. Lastly Ensuring constant review and assessment of change process is important. Change is a process not an event.

4. Relationship of learning with organizational change.

Orgs that effectively change are ones that have first have learned how to recognize the need for change and have learned what actions are necessary to adapt. A LEARNING ORGANIZATION is one that facilitates the learning of all its members and consciously transforms itself and its context. Learning in this sense involves 1. Adapting to their environment 2. Learning from their people 3. Contributing to the learning of its stakeholders.

Organizational development is a process of planned system change that attempts to make organizations better able to attain their short and long term goals. It is achieved by teaching organization members to manage their organization processes, structures and culture more effectively.

Organizational learning has been defined as the detection and correction of error.

There is 2 types of learning... Single Loop and Double Loop learning, the latter that constitutes genuine organizational learning.

Single Loop – seeks to resolve problems by attending to symptoms. Ex. Employees are stealing so you put locks on doors. Individuals engaging in single-loop learning or adaptive behavior are essentially functioning within the boundaries or constraints of the presented problem. Typically results in making INCREMENTAL improvements.

Double-Loop – required individuals to assess whether an error or problem exists in an organization because the systems themselves need to be changed. Attends to symptoms and ROOT CAUSES. Modifies underlying policies and goals. Questions why the problem arose in the first place. Organizations typically create systems that inhibit double loop learning because of their bureaucratic natures. Change is accomplished through double loop learning.

Double-Loop learning and Shifting Paradigms –

PARADIGM – a set of beliefs or mental framework for understanding how the world operates. Relates to our values and priorities so a change of paradigm or paradigm shift means changing the way in which we view the world and challenging our value systems. Change can only come about when members of an organization are encouraged in double-loop learning. It makes a dramatic departure from the present way of doing things. This is the notion of shifting paradigms and failure to do so can result in a similar situation Swiss Watch experienced when they failed to recognize the importance of the electronic technology discovered by their own researchers. They passed on the idea and the Japanese capitalized on their misjudgment and successfully took a giant portion of the market away from Swiss. **Swiss failed to make the paradigm shift.** Overcoming resistance to change is all about being able to do two things: recognize the current paradigms that govern our behavior and shift to a new paradigm. Swiss manufacturers were being prisoners of their old paradigm.

Do organization encourage or discourage learning and change?

Organizational learning and development are facilitated through **individual learning and development**. Individual change is about learning new skills, developing new perspectives and new ways of dealing with everyday challenges. Traditional bureaucratic structures are rapidly being replaced by organic structures and it would seem critical to similarly shift greater attention to a more adaptive innovative type of employee better suited for the changing needs of the new organization.

Adults continue to learn throughout their lifetimes and their past experience can help or hinder this learning. The workplace is an important element in adult development with the power to foster or impede development of its members. **ORGANIZATIONS THAT ENCOURAGE SELF-EXPLORATION and information seeking, will facilitate individual growth and development.**

Adult development is based on change rather than stability and this change or growth occurs at a predictable rate and sequence. Development grows out of interaction of both internal psychological events and external social events.

Institutionalization involves the processes by which shared beliefs take on a rule-like status. It has been defined as a social process through which individuals create a shared definition of what is appropriate or meaningful behavior. Organizations often generate “accepted practices” that tend to govern how things are done. These practices may continue even when they are no longer functional simply because they have become ingrained part of the org.

Organizational policy can discourage employees from thinking outside the box. COGNITIVE SCRIPTS are mental pictures or ‘recipes’ for how to think and behave. May be difficult to change but they can help to guide behavior. Every organization possesses shared meaning regarding how its members should conduct themselves in the performance of their duties.

Individuals within orgs often rely on **pre-programmed scripts** which internalize a routine approach to performance on the job. Use of scripts to guide behavior in the workplace can discourage individuals from critically examining events and situations each time performance is required.

5. Role of the Tipping Point and its impact on change.

Gladwell has developed three rules of epidemics in his book the tipping point. He describes change as seeing a virus when it reaches critical mass aka boiling point.

Rule 1 – the law of the few – there are exceptional people who possess social connections, personality and energy to be able to spread the word (idea or product) - These EXCEPTIONAL who essentially control the power of word-of-mouth epidemics are divided into three categories. **1) Connectors** – they know a lot of people and are critical to the instigation of a

word-of-mouth. **2) Mavens** – these are people who have a lot of information on a lot of different products, prices and places. They are important in starting word-of-mouth because they know things others don't. **3) Salesmen** – have skills to persuade those who are not convinced by the data provided by mavens or the message spread by connectors.

Rule 2 – The Stickiness factor – there are specific ways to make a message memorable in terms of presenting and structuring information to influence the impact it will make. Specific ways of making a message for change 'stick' so that people accept it. Perfect example is Sesame Street and how it was created to cause an epidemic of literacy in children.

Rule 3 – The Power of context – described in 2 parts. 1) epidemics are sensitive to the conditions and circumstances of the times and place in which they occur. The broken window theory supports this. If a window is broken and left unrepaired, people will assume that there is no place for authority and in turn more windows will be broken. 2) the critical role that groups play in social epidemics. The place where change happens is important and the people in the context can encourage change in small ways. Humans are a lot more sensitive to their environments than they may think.

It has been suggested that change that begins from a top-driven fashion will not lead to success as opposed to change that is initiated by the managers and employees. At the grassroots level there is a greater understanding of the individual roles and responsibilities and the changes that are required to bring about change.

6. Change issues in the context of corporate mergers.

A merger is when two (or more) organizations come together to form one larger organization

- a. Can be very useful for enhancing market strength
- b. Encourage diversity and change

But: 50% of all mergers fail because of inappropriate change management practices.

Employees attach meaning to their employers which helps them establish identity.

If the identification of employees with their organizations is very strong resistance to the change event will likely occur given that a merger and acquisition is perceived as a threat to their old identity, which is founded in their original employer.

A merger can have profound effect on one's sense of self or identity simply by confusing the lines of membership within a group. Employees perceive their futures to be uncertain and their cognitive attachment with their original employer strained. As a result they resort to activities such as fostering an "us vs. them" attitude.

Mergers call for the reconstruction of identity given that there are two entities aligning each with already well established histories and customs. Identity theory states that it is in these

circumstances that members of the affected organizations will try to promote their own identity as the superior choice within the newly established organization.

Research concerning identity reveals the concept of continuity – particular aspect of employee previous connections to their employers help ease the transition into the new alliance. The **concept of continuity** neither suggests a full departure from old identity constructs nor the need to craft a completely new identity, but rather an identity based on the retention of the fundamental components of the old activities while attempting to embrace some components of the new identities.

Culture can be described as the nature in which an org approaches its work, its direction and sense of priority. It plays a significant role in any change event and most certainly within the context of a merger.

Acculturation is a process in which members of each org begin to recognize the differences in each culture and ideally begin to embrace components within each. Differences can include rituals, routines, process methodologies and corporate ethics. Acculturation can be very difficult because of **culture clash** where each side wants to stick to their own old way of doing things. If the new org falls short of addressing culture class the consequences can include low morale, and decrease in productivity. The analogy of a marriage can be used to illustrate the unique dynamics that often confront a new alliance.

There are many initiatives the newly merged organizations can undertake to try and lessen the impact of a change transition. Creating an atmosphere that promotes and advocates multiculturalism. **Cross cultural presentations** to educate members of each merging partner about each other's cultures. This can decrease anxiety levels associated with mergers.

Trust is a critical element in any change effort. A high level of trust among employees and their employer is necessary condition if a merger is going to succeed. Trust is the belief that one party can expect the other party to fulfill an obligation.

COMMUNICATION. Organizations must plan and execute a communication strategy that addresses two primary goals. **1)** Organization must be perceived by those affected to be capable of the execution of the change effort. **2)** The change must be seen as a reasonable and required need in order to solicit commitment. If leaders are successful in conveying the need for change among their employees and if there is an existing degree of trust already present employees can react by embracing decisions that may not seem advantageous. **Leaders who demonstrate a free exchange of information and demonstrate the need for change generally elicit a greater degree of trust among their employees.**

