Business strategy for A2

David Dyer
Director of Cambridge Business Studies Trust
Peter Stimpson
Hurtwood House, Surrey

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Contents

1 Setting corporate objectives

On completion of this chapter you should be able to:

- ➤ understand the differences between mission statements, corporate objectives and business strategy
- ➤ understand how business culture shapes and determines corporate objectives
- ➤ understand the significance of objectives as the basis for strategy
- ➤ assess the importance of communicating objectives through corporate plans and mission statements
- ➤ evaluate the impact differing stakeholder objectives have on the behaviour and decisions of the firm

Introduction

This book will help you develop:

- ◆ a more detailed grasp of essential Business Studies concepts and processes;
- ◆ skills of analysis and evaluation;
- ◆ an awareness of the integrated nature of the subject.

The emphasis in this first chapter is on the nature and development of corporate objectives and the forces which can influence and lead to a change in these objectives. Almost all aspects of human activity are made clearer and more focused if there is a special objective to aim for and an appropriate **strategy** – or detailed plan – in place to direct and review human effort. These plans will themselves be driven by the nature of the objectives towards which people or organisations are striving. Consider these examples:

- ◆ British Petroleum changed its corporate logo from the familiar crest to that of a flower resembling a sunflower – this would seem to be a pointless move unless it is seen in the context of a repositioning of the business towards a more caring and environmentally concerned organisation.

Solar House at the G8 Solar Showcase. *Source*: BP AMOCO plc.

- Hopefully, your arrival in the sixth form was part of a longer-term plan to achieve qualifications to give you more career choices and greater earning potential. Do you know of some of your fellow students who have drifted into sixth form education without a clear aim? Are they less or more motivated than you in academic work?
- The government makes many tax and spending changes in its annual budget but, without a sense of direction or purpose in what it is trying to achieve, these changes would be difficult to justify and explain to the voters. A general increase in taxes without an explanation that the funds raised would, for example, be used to increase pensions would not be well received.
- The English football team was criticised for poor performance in 2000. Some commentators believe that the major problem was the absence of a clearly formulated playing strategy. The aim is clear – to win matches – but the playing strategy seemed not to have been well communicated to or understood by the players.

Mission statements, aims, objectives, plans and strategies – what do they all mean?

The links between these concepts can be made clearer by studying this 'hierarchy of objectives' (Figure 1.1) which shows, visually, the balance and dependencies between the different stages in the setting of aims and objectives. Later in this chapter we will consider the importance of these objectives to business strategies.

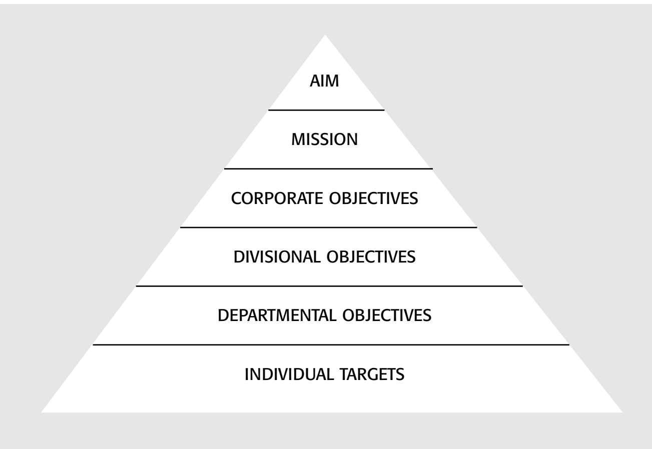


Figure 1.1 A hierarchy of objectives

Corporate aims

These are the very long-term goals which a business hopes to achieve. The core of a business's activity is expressed in its corporate aims and plans. The term is rather misleading because it is not just companies which have these goals. Sole traders and partnerships will also, commonly, develop the same kind of long-term vision for their business.

Case study – 'A mini Glaxo by 2010'

Vijay Patel is a self-made millionaire. He is the founder chairman of Waymade Healthcare, a drugs company. Although he has achieved considerable wealth already he is not ready to give up: 'I've got a long way to go. It isn't about making more wealth. It's about achieving the goals I have set for my business. My ambition is to become a mini Glaxo by 2010.'

[Glaxo is one of the world's leading pharmaceutical companies.]

Source: Adapted from *Sunday Times*, 10 September 2000.

The case study demonstrates a typical corporate aim. Vijay Patel tells us that he wants the business to remain in the same industry but to develop and grow to achieve the same degree of recognition, albeit on a different scale, to one of the market leaders.

Other corporate aims tend to concentrate on customer-based goals – such as 'meeting customers needs' – or shareholder-based goals – such as 'increasing value for our shareholders'. All corporate aims have certain characteristics in common. They are all embracing, that is they are designed to provide guidance to the whole organisation and not just a part of it. Also, they are statements of goals, not strategies, as they give no indication of how these aims might be reached.

What benefits flow from establishing corporate aims?

- They become the starting point for the entire set of objectives on which effective management is based. This is shown by their position at the top of the 'pyramid of objectives' in Figure 1.1.
- They can help develop a sense of purpose and direction for the whole organisation if they are clearly and unambiguously communicated to the workforce.

- They allow an assessment to be made, at a later date, of how successful the business has been in attaining its goals.
- They provide the framework within which the strategies or plans of the business can be drawn up.

A business without a long-term corporate plan is likely to drift from event to event without a clear sense of purpose. This will quickly become obvious to the workforce and customers, who may respond in adverse ways.

It is becoming increasingly common for businesses to express the corporate aim in one short, sharp 'vision-like' statement to be made known to as many stakeholders as possible. This is termed a **mission statement**.

Mission statements

This is an attempt to condense the central purpose of a business's existence into one statement. It is not concerned with specific, quantifiable goals but tries to sum up – often in rather woolly language it must be said! – the aims of the business in a motivating and appealing way. Therefore, a definition is:

A statement of the business's core aims, phrased in a way to motivate employees and to stimulate interest by outside groups.

Here are some examples of mission statements:

Sixth form college: 'To provide an academic curriculum in a caring and supportive environment.'
British Telecom: 'To be the most successful worldwide telecommunications group.'
Unigate: 'We are committed to consistent profitable growth as the means by which we can provide attractive returns to shareholders, be a responsible employer and support the communities in which we operate.'
Kingfisher plc: 'We aim to be world class retailers with market leading businesses that meet customers' needs by offering reliable and consistent value.'

Evaluation of mission statements

Virtually any organisation of any size has in recent years established a mission statement. Do they perform a useful function or are they just another management 'fad'?

Some of the arguments used in favour of mission statements seem to be:

- They quickly inform groups outside the business what the central aim and vision is.
- They can prove motivating to employees especially where an organisation is looked upon, perhaps as a result of its mission statement, as a caring and environmentally friendly body. Employees will then be associated with these positive qualities.
- When they include moral statements or values to be worked towards, then these can help to guide and direct individual employee behaviour at work.
- They are not meant to be detailed working objectives but they help to establish in the eyes of other groups 'what the business is about'.

On the other hand, these statements are often criticised for being:

- too vague and general so that they end up saying little which is specific about the business or its future plans;
- based on a public relations exercise to make stakeholder groups 'feel good' about the organisation;
- virtually impossible to really analyse or disagree with;
- often rather 'woolly' and general, so it is common for two completely different businesses to have very similar mission statements.

Communicating mission statements is almost as important as establishing them. There is little point in identifying the central vision for a business – and then not letting anyone else know about it. Businesses communicate their mission statements in a number of ways. They often feature in the published accounts and in other communications to shareholders. Internal company newsletters and magazines may draw their title from part of the mission statement. Advertising slogans or posters are frequently based around the themes of the mission statements – The Body Shop is most effective in incorporating its mission into the different eco-friendly campaigns it launches.

Activities

1 Using either company web sites or printed published accounts, discover the 'missions' of three well-known public limited companies.
2 Analyse how much these mission statements tell you about the visions and operations of these businesses.
3 Suggest how the statements that you have researched might be communicated to three different stakeholder groups.
4 Discover if your school or college has a 'mission statement'. By asking staff, students and parents, attempt to establish whether this statement has had any impact on their view of the school.

In summary, mission statements, rather like the corporate aims on which they are based, are insufficient for operational guidelines. They do not tell managers what decisions to take or how to manage the business. They provide a vision and an overall sense of purpose and in public relations terms at least, they can prove very worthwhile.

Corporate objectives

The aim and mission statements of a business share the same problems – they lack specific detail for operational decisions and they are rarely expressed in quantitative terms. They need to be turned into goals or targets which are quite specific to each business and which can, themselves, be broken down into strategic departmental targets. **Corporate objectives** are designed to do just this. They are, of course, based upon the central aim or mission of the business but they are expressed in terms that provide a much clearer guide for management action or strategy.

Common corporate objectives

Maximising profits All the stakeholders in a business are working for reward. Profits are essential for rewarding investors in a business and for financing further growth. Profits are necessary to persuade business owners – or entrepreneurs – to take risks. What, though, does profit maximisation mean? In simple terms, it means producing at that level of output where the greatest positive difference between total revenue and total costs is achieved. This is shown in Figure 1.2.

The chief argument in support of this objective is that it seems rational to seek the maximum profit available from a given venture. Not to do so is seen as a missed opportunity. There are serious limitations with this corporate objective, however:

Case studies

Buy as You View sells television sets and other electrical appliances to relatively poor households. It aims to make a profit for shareholders – indeed in 2000 it made a profit of £5m. The corporate objectives are rather more detailed:

- to establish a nation-wide operation – currently it is heavily focused on the market in Wales;
- to reinforce an ethical image in all of its market regions in the UK;
- to derive additional benefit from its community spending programme.

Happy Computers is an information technology business. Although it recorded a loss of £40,000 in 1999, as a result of contract problems with a landlord, it is a successful concern. In 2000 its corporate objectives were reported as being:

- to return a profit;
- to establish itself as a market leader in on-line training courses;
- to raise the company profile through responsible social and community policies.

Source: Adapted from *Sunday Times*, 10 September 2000.

Cadbury Schweppes has the business aim of 'increasing the value of the business for our shareholders'. To achieve this aim it has adopted a 'managing for value' philosophy based upon these objectives:

- to increase earnings per share by at least 10% per year;
- to generate free cash flow of at least £150m per year;
- to double the value of shareholders investments in four years.

Source: Company Report, 1998.

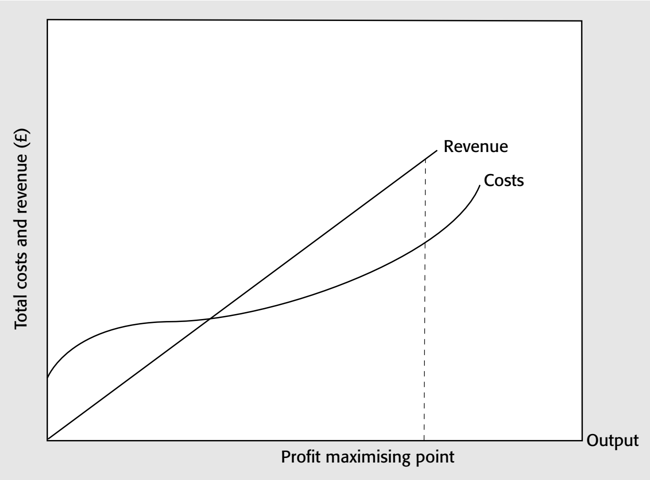


Figure 1.2 Profit maximisation – the greatest possible difference between total revenue and total cost

- The focus on high short-term profits may encourage competitors to enter the market and jeopardise the long-run survival of the business.
- Many businesses seek to maximise sales in order to secure the greatest market share possible, rather than maximise profits. The business would expect to make a target rate of profit from these sales.
- The owners of smaller businesses may be more concerned with ensuring that leisure time is safeguarded. The issues of independence and retaining control may assume greater significance than making higher profits.
- Most business analysts assess the performance of a business through return on capital employed rather than through total profit figures.

Activity

Read the case study below and then tackle the exercises that follow.

Case study – Wm Morrison ambitious to expand

Sir Ken Morrison, chairman of Wm Morrison, yesterday signalled his ambitions to expand the north of England supermarket group.

He was reporting a 9 per cent rise in interim profits on a 15 per cent jump in sales. He said Morrison's was 'uniquely positioned to take advantage of any acquisitions which may arise'.

He said strong cash flow and a net bank balance of £43.3m at the half year put Morrison's in an advantageous position.

Morrison's was clearly interested in taking advantage of expansion opportunities, said one analyst, adding: 'It would be able to raise £400m–£600m to buy new stores, with its balance sheet and strong cash flow.'

'Further, the benefits to Morrison's of growth are greater than to any of its peers. Being smaller, even 20 stores will make a bigger difference and it has been able to make new assets significantly outperform anyone else.'

For the 27 weeks to August 6, the group reported pre-tax profits of £91.6m, after a £5.2m exceptional gain on disposals, up from £79.2m.

Sales were £1.71bn, against £1.49bn last time. Sir Ken said sales excluding new space and petrol rose 6 per cent, substantially ahead of the industry average.

Like-for-like sales growth in the five weeks to September 10 was 5.6 per cent excluding petrol, again significantly ahead of the industry, which is reported to be showing sales growth of between zero and 1 per cent.

Sir Ken said intensifying competition was putting pressure on margins, but he was confident that the full year would 'continue to see good progress'.

Gross margins in the half year fell from 23.9 to 23.3 per cent, as the group sought to drive sales volumes through lowering prices.

One analyst said the decline was also due to the group's determination to increase non-food sales, which had shown like-for-like increases of 23 per cent. 'They have been deploying significant cuts in non-food prices since Easter, but it has paid off,' he said.

Forecasts were held at about £210m.

The interim dividend is increased by 11.1 per cent to 0.3p, on earnings up 18 per cent at 3.81p. The shares closed up 4p at 167p.

Source: Peggy Hollinger, *Financial Times*, 22 September 2000.

(a) Suggest reasons why Morrison's has a corporate objective of business expansion.
(b) What evidence is there in the article that Morrison's is well able to finance expansion?
(c) Discuss the decision by Morrison's to aim for growth in sales by lowering prices and profit margins.

- **Profit maximisation** may well be the preferred objective of the owners and shareholders but other stakeholders will give priority to other issues. Business managers cannot ignore these. Hence, the growing concern over job security for the workforce and the environmental concerns of local residents may force profitable business decisions to be modified, yielding lower profit levels.
- In practice, it is very difficult to assess whether the point of profit maximisation has been reached and constant changes to prices or output to attempt to achieve it may well lead to negative consumer reactions.

Growth The growth of a business – usually measured in terms of sales – has many potential benefits for the managers and owners. Larger firms will be less likely to be taken over and should be able to benefit from economies of scale. Managers will be motivated by the desire to see the business achieve its full potential, from which they may gain higher salaries and fringe benefits. It is also argued that a business that does not attempt to grow will cease to be competitive and, eventually, will lose its appeal to new investors. Business objectives based on growth do have limitations, though:

- expansion which is too rapid can lead to cash flow problems;
- sales growth might be achieved at the expense of lower profit margins (see previous activity);
- larger businesses can experience diseconomies of scale;
- using profits to finance growth – retained profits – can lead to lower short-term returns to shareholders;
- growth into new business areas and activities – away from the firm's 'core' activities – can result in a loss of focus and direction for the whole organisation.

Increasing market share Closely linked to overall growth of a business is the market share it enjoys within its main market. Although the two are usually related, it is possible for an expanding business to suffer market share reductions, if the market is growing at a faster rate than the business itself. Increasing market share indicates that the marketing mix of the business is proving to be more successful than that of its competitors. Benefits resulting from having the highest market share – being the brand leader – include:

- retailers will be keen to stock and promote the best-selling brand;
- profit margins offered to retailers may be lower than competing brands as the shops are so keen to stock it – this leaves more profit for the producer;
- effective promotional campaigns are often based on 'buy our product with confidence – it is the brand leader'.

Social, ethical and environmental considerations
Should firms have objectives about these issues? Increasingly, there is general agreement that firms must adopt a wider perspective when setting their objectives, not just those of profits and expansion. One reason for this is the much greater adverse publicity given to business activity that is perceived as being damaging to stakeholder groups and the wider world. Increasingly influential pressure groups are forcing businesses to reconsider their approach to decision making. Also, legal changes – at local, national and the EU level – have forced businesses to refrain from certain practices. Firms can no longer pay staff very low wages or avoid legal responsibility for their products. Managers clearly wish to avoid conflicts with the law or bad publicity. There are other reasons for these trends in business objectives – increasingly, consumers and other stakeholders are reacting positively to businesses that act in 'green' or socially responsible ways. Examples include:

- firms that promote organic and vegetarian foods;
- retailers that emphasise the proportion of their products made from recycled materials;
- businesses that refuse to stock goods that have been tested on animals or foods based on GM ingredients.

In these cases is the action being taken because trade and reputation might be lost if they don't or because such lines of action are increasingly profitable? Might businesses be criticised for 'jumping on the social bandwagon' rather than praised for their genuine concern for society and the environment? Conceivably, firms are being ethical or environmentally conscious because they have an objective that Peter Drucker, a famous writer on management, calls 'public responsibility', because they want to behave in these ways. Many consumer groups and pressure groups are still dubious as to whether these objectives are based on genuinely held beliefs or not. However, there are increasing signs that there is a real and growing concern for ethical behaviour and environmental issues amongst businesses.

Activity

Consider the figures in the table below relating to the company STS Ltd.

Year	1998	1999	2000	2001	2002
Sales volume (000)	400	420	450	490	550
Sales revenue (£000)	600	609	630	676	760
Total market volume (millions)	3	4	5	5.5	6.5

(a) Calculate the annual % increase in the volume of sales for STS Ltd.
(b) Calculate the annual % increase in sales revenue.
(c) Compare and discuss your results for (a) and (b).
(d) What is happening to the market share of this business?
(e) Evaluate different courses of action the business might take to increase market share.

Examples of other possible corporate objectives include:
Maximising sales revenue – this could benefit managers and staff when salaries and bonuses are dependent on sales revenue levels.
Maximising shareholder value – this could apply to public limited companies and help to direct management action towards taking decisions that would increase share prices and returns to shareholders.
Concentrating on core activities – the move away from huge 'conglomerate' organisations with interests in a wide range of industries is being driven by the aim of many senior managers to concentrate on 'high value, high profit margin' activities.

The main issues relating to corporate objectives

- They must be based on the corporate aim.
- They should be achievable and measurable if they are to motivate employees.
- They need to be communicated to employees and investors in the business.
- They will form the framework of more specific departmental or strategic objectives.
- They should indicate a time scale for their achievement.

All of these features are evident in the corporate objectives of Cadbury Schweppes referred to on page 4.

Cadbury Schweppes: aiming to double the value of shareholders investments in four years. *Source*: Cadbury Schweppes.

Activity

Read the case study below and then answer the questions that follow.

Case study – Iceland spends £8m a year to sell organic food at no extra charge

Iceland, the frozen food supermarket, yesterday launched an ambitious attempt to transform organic food from a middle-class speciality to a staple of the mass market, saying it would spend £8m a year providing organic produce at no extra cost to consumers.

The company, which led the retail sector's rejection of genetically modified foods when it banned GM ingredients two years ago, said it had secured 40 per cent of the world market in organic vegetables.

The initiative is a challenge to the big food retailers, who have begun stocking organic alternatives to conventional food but usually charge more for what remains a niche item.

The big supermarkets were defiant, saying they did not intend to follow suit. J Sainsbury, which has 30 per cent of sales of organic goods against Iceland's 1 per cent, questioned whether the company's approach was sustainable.

'There are extra costs and that has to be reflected in the price,' it said. 'We do not make any more money from organic than conventional food.' However, it was working with suppliers to bring down prices through economies of scale.

Malcolm Walker, Iceland's chairman, said he was confident the £8m annual outlay, which represents 12 per cent of the company's profits last year, would pay off.

The organic market was forecast to grow 40 per cent a year for the next five years and research had shown 50 per cent of consumers would switch to organic produce if it cost the same. 'This isn't a profits warning. We are confident we'll sell more as a result,' he said.

Analysts said Iceland would only need a 2 per cent sales lift – £35m–£40m a year – to offset the investment, which could be generated by initial publicity. 'There is a lot of PR in here. Will the PR give the sales uplift to make it pay? Historically, Iceland has won those bets,' said one analyst.

Analysts were sceptical that the investment represented a new pressure on margins. Much of the investment could be diverted from budgeted marketing spend.

Iceland said that by October it would stock only organic vegetables. It would then consider switching to organic in other food ranges. The company is also injecting £1m into the National Trust, the UK's biggest landowner, to promote environmentally friendly agriculture among 700 tenant farmers.

The switch to organic, to which Iceland says it is committed for at least three years, follows a series of marketing moves that have often been dismissed initially by competitors.

However, the big food retailers have eventually followed Mr Walker's lead, first on home delivery and then on abolishing GM ingredients. The strategy has paid off for Iceland, which has seen pre-tax profits rise from £50.2m in 1998 to £65.3m last year.

Source: Michela Wrong and Peggy Hollinger, *Financial Times*, 5 September 2000.

(a) What do you understand by the term 'mass market'?
(b) Assess the expected costs and benefits to Iceland of its decision to sell only organic fruit and vegetables.
(c) What evidence is there in the article, apart from the organic food decision, that Iceland is acting in a socially responsible manner?
(d) Why is 'PR' considered to be so important as a means of communicating these decisions to Iceland's stakeholders?
(e) By January 2001, it was clear that the 'organic food only' strategy was not leading to the expected increase in sales and Iceland started to review its original decision. Examine possible reasons why the forecasted increase in sales was not achieved.

Factors which determine the corporate objectives of a business

Corporate culture Clearly, not all businesses pursue the same objectives. There are several factors that influence the nature of the objectives established for any business. Chief amongst these is the culture of the organisation. This can be defined as the code of behaviour and attitudes that influence the decision-making style of the managers and other employees of the business. Culture is a way of doing things that is shared by all those in the organisation.

According to Cadbury Schweppes 1999 Annual Report, 'Culture is about people, how they deliver, what they are accountable for, how aggressive they are in the pursuit of objectives and how adaptable they are in the face of change.'

The culture of a business will, itself, be determined by several factors.

In small firms, in particular, the personality and management style of the owner and leader will impact heavily on the approach of the rest of the staff. An aggressive, 'profit at all costs' type of entrepreneur will quickly communicate to the organisation the attitudes to be adopted in decision-making situations. A second factor influencing culture is the structure of the organisation. A tightly centralised and rigid organisational structure based on a hierarchical system will tend to make the business more resistant to change and less able to adapt to fluctuating market trends. Only senior managers will be able to take significant decisions and a culture of fear may prevail through the organisation.

Since culture is the all important framework of a business it must help to determine objectives. Some business cultures are adaptive: they are open to change and often actively seek it. In the modern world, this is likely to increase the chances of survival. In such firms employees will be encouraged to accept change rather than resist it, to be innovative and creative and to challenge each other.

The nature of business culture is often defined by its focus. In some firms the focus is almost solely on 'getting the job done'. The task assumes greater significance than the people doing it. This is called '**task culture**'. Many organisations whose approach is close to **McGregor's theory X** are of this kind. At the other extreme are those businesses that are people orientated, with great concern for the people doing the job and the extent of their involvement in it. This is referred to as '**people culture**'. Such managements are bound to be **McGregor's theory Y** in their approach. They will be convinced that this attitude will bring good productivity because of high team spirit, co-operative spirit and high motivation.

Thus, business culture will determine:

- the objectives of the business;
- the way in which the objectives are expressed;
- the involvement of the workforce in setting them;
- how the actions required to achieve objectives are determined and put into effect;
- the motivation the workforce show in their efforts towards the achievement of objectives.

The size and legal form of the business Small-business owners may be concerned only with a satisfactory level of profit – called 'satisficing'. Larger businesses, perhaps controlled by directors rather than owners, such as most public limited companies, might be more concerned with rapid business growth in order to increase the status and power of the managers.

Public or private sector businesses State-owned organisations tend not to have profit as a major objective. The aims of these organisations can vary greatly but when the service they provide is not ‘charged for’, such as education and health services, then a financial target would be inappropriate. Even businesses earning revenue in the public sector – such as the Post Office – may have, amongst their objectives, the target of maintaining services in non-profitable locations. Recent branch closures in rural areas by private sector banks, in order to increase profits, makes an interesting contrast.

The number of years the business has been operating Newly formed businesses are likely to be driven by the desire to survive at all costs – the failure rate of new firms in the first year of operation is very high. Later, once well established, the business may pursue other objectives’, such as growth and profit.

Divisional, departmental and individual objectives Refer to Figure 1.3 below. Once corporate objectives have been established they need to be broken down into specific targets for separate divisions, departments and, ultimately, individuals. Corporate objectives relate to the whole organisation. They cannot be used by each division of the business to create strategies for action

St Bartholomew’s Hospital, London, a public sector organisation.
Source: St Bartholomew’s Hospital.

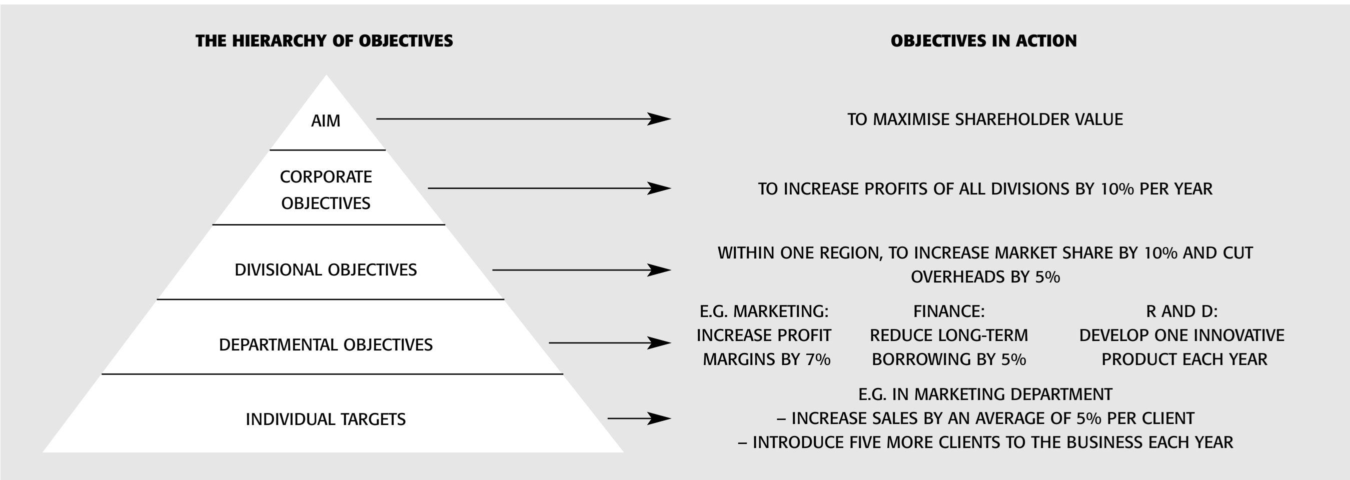


Figure 1.3 Management by objectives – how the corporate aim is divided at every level of the organisation

Activities

1 Think about the organisation in which you undertook your research assignment. Identify the culture of that business. Do you think the culture had a positive or negative effect on the success of the business?
2 If you have a part-time job, compare the culture of this organisation with that of your 'project' firm. If you consider them to be different, suggest reasons for this.
3 (a) Analyse and evaluate the culture of your school or college.
(b) How has it changed in recent years?
(c) Do you consider that it has changed sufficiently? Give reasons and propose changes.

until they have been broken down into meaningful targets focusing on divisional goals. These divisional objectives must be set by very senior managers to ensure:

- co-ordination between all divisions – if they do not work together the focus of the organisation will appear confused to outsiders;
- consistency with corporate objectives;
- that adequate resources are provided to allow for the successful achievement of the objectives.

Once the divisional objectives have been established, then these can be further divided into departmental objectives and targets for individual workers. This process is called **Management by Objectives (MBO)**. It is a system which is designed to motivate and co-ordinate a workforce by dividing the organisation's overall aim into specific targets for each division, department and individual.

If this process is undertaken after discussion and agreement with personnel at each level of the organisation then it can be a very effective way of delegating authority and motivating staff. This approach would accord with a theory Y approach. If, however, the targets at each level were merely imposed from above – as with a theory X style – then motivation is likely to be low.

Figure 1.3 is an example of how the hierarchy of objectives could now look incorporating the principle of Management by Objectives (The mission statement has not been included, as we have identified that it is of little operational use.)

MBO – the possible benefits

- For the MBO system to be effective, targets and objectives should be agreed and discussed with the managers and staff at a departmental and an individual level. This form of staff involvement is a key feature of job enrichment and should help provide a motivating force.
- Each manager and subordinate will know exactly what they have to do. This will help them prioritise their time. It will also enable them to see the importance of what they do to the whole organisation.
- By using the corporate aim and objectives as the key focus to all departmental and individual objectives, everyone should be working to the same overall target. This will avoid conflict and should ensure a consistent and well-coordinated approach.
- Objectives act as a control device. By setting targets agreed with the people who have the authority to reach them, managers are able to monitor everyone's performance and measure success or failure.

MBO – the possible problems

- The process of dividing corporate objectives into divisional, departmental and individual targets can be very time consuming, especially as this is best performed only after full consultation with those most affected.
- Objectives can become outdated very quickly and fixing targets and monitoring progress against them can be less than useful if the economic or competitive environment has changed completely.
- Setting targets does not guarantee success as some managers might believe. Issues such as adequate resources and staff training must also be addressed if the original targets are to have any real meaning or are to act as true motivating goals.

Establishing strategy

Aims and objectives are the targets that businesses work towards. Strategies are the long-term plans that are needed to reach those targets. A strategy is, therefore, a 'means to an end'. Any business strategy will be influenced by four main factors (see Figure 1.4).

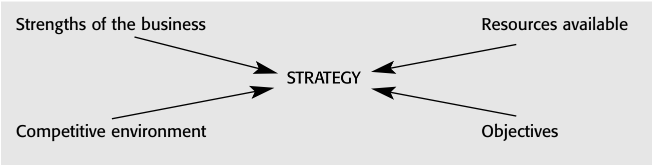


Figure 1.4 Influences on strategy formation

Strengths of the business

If a business has proven capabilities in certain areas – e.g. in researching heart disease drugs or in converting large country houses into apartments – it is often wisest to apply these strengths when devising future strategies. A long-term plan which takes a business away from a proven field of operation may require business skills and experience it does not have. In addition, expansion of the business may be best achieved if some low-performing areas of the business (or non-core businesses) are sold off. In this way the firm will be concentrating on its current successes to achieve growth. Thus, Whitbread, formerly one of the largest brewers in the UK, sold off its brewing interests in 2000. The finance raised is being invested in the hotel and restaurant section, offering faster growth and higher profit margins.

Resources available

All business resources are finite. Scarce resources will force firms to choose which projects to proceed with and which to drop. A strategy of launching a new product 'nationwide' may have to be scaled down because of lack of resources.

Competitive environment

Competitors' actions are a major constraint or limit on business strategy. New innovations by competitors may be difficult to copy or to better. Major new promotional campaigns could prove to be very effective. All businesses operate in a competitive environment to a greater or lesser degree. Price reductions by supermarkets selling petrol in the UK forced a change of strategy on to the main petrol retailers. Esso quickly adopted a 'price watch' strategy, which promised prices as low as local supermarkets. Would this plan have been introduced without competitive pressures?

Objectives

Clearly, the objectives of the business will influence strategy. Increasing shareholder wealth in the short term might not be best served by investing in extensive Research and Development with a payback many years into the future. Increasing market share as an objective may not be achieved if the efforts of the business are being directed towards entering completely new markets with new products.

Corporate and divisional strategies

Once an overall strategy has been agreed upon by the Board of Directors, divisional or departmental plans have to be established. These must be well co-ordinated to ensure that departments do not introduce conflicting and counterproductive policies. An example of how the corporate strategy might be broken down is shown in Figure 1.5.

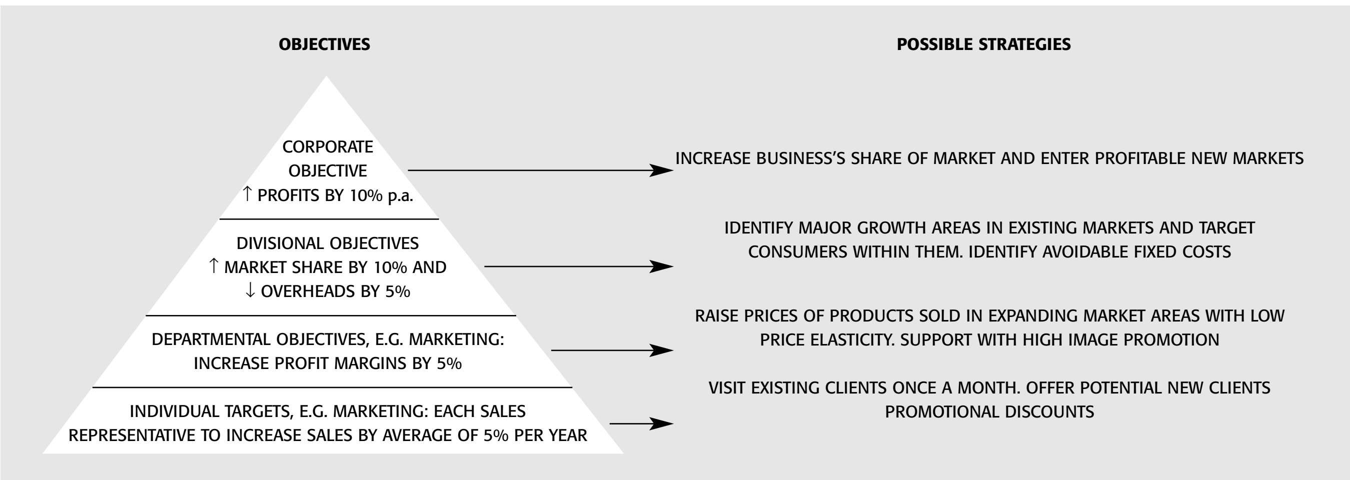


Figure 1.5 Corporate and divisional strategies in action – the links between objectives and strategies

Stakeholders and their objectives

There are many stakeholders in a business. Ideally all stakeholders will have common views on what the corporate aims should be. This is, in reality, most unlikely. The reasons for groups having a stake in any business are so fundamentally different that there will be many occasions when their interests diverge and even conflict. A business has to find a way of satisfying these different interests – especially those of powerful and influential stakeholders – but there is no sure or safe route through this dilemma. Table 1.1 shows a summary of the main business stakeholders and their most likely interests.

Here are some of the issues involved when considering the objectives of certain important stakeholders.

Activity

Study Table 1.1 carefully.

(a) Note down situations in which the objectives of a particular stakeholder might conflict with:
- the objectives of other stakeholders;
- the objectives of the business.

(b) Discuss how any two conflicts that you have identified might be resolved by the managers of the business.

Stakeholder	Main objectives
Directors	To direct the strategy and major decision making of the business. To retain control. To increase their own power and status from business growth.
Shareholders	To receive dividends from after-tax profits. To share in the success/profitability of the business through an appreciating share price.
Workforce	To receive a 'fair' wage. To ensure good working conditions. To secure their jobs through the survival and expansion of the business.
Customers	To obtain 'good value for money' from the goods and services purchased. To receive high levels of customer service. To receive after-sales service and supply of spares from a business which survives into the future.
Suppliers	To continue to sell profitably to the business. To be paid promptly and fully for goods supplied.
Banks/Lenders	To be paid back in full when repayments are due. To receive interest on the loan when due.
Community	To benefit from the employment the business creates. To be free from environmental disadvantages the firm might generate.
Government	To receive tax revenue from profitable firms. To direct the operations of the business for the benefit of the community/nation. To control business operations and performance to ensure it remains within national and EU laws. To assist the business in accordance with local and national policy.
Competitors	To compete by all lawful means. To differentiate its products from those of other businesses. To compare and contrast performance with other businesses.

Table 1.1 Stakeholders of a business and their main interests

Shareholders Investors clearly want to be rewarded for their stake in the business. This reward must be at least equal to that which would be available elsewhere and should also reflect the measure of risk associated with investing in a particular business. For example, investors in 'Bio Tech' businesses are expecting high rewards because of the risk associated with this type of research – that is, it may not be commercially successful. Shareholder reward comes from the annual dividend and increased prices for the shares they own. The extent of reward to shareholders is dependent on a number of factors:

- the size of after-tax profits – determined by company performance but also by the gearing ratio of the business as interest on loans is always paid before tax, and, therefore, before dividends;
- the plans of the directors to retain profits for future development of the business;
- the prospects for the company and the economy in general will be the main driving forces behind share price changes.

Shareholders are protected by law because their position is thought to be weak compared to the business itself. The main rights they have are:

- to receive annual accounts;

- to attend the Annual General Meeting to vote on matters such as the election of directors – shareholders cannot, however, vote to *increase* the dividend proposed by directors at this meeting (this removes the risk of shareholders taking profits out of the company, that cannot easily be afforded, just for short-term gain);
- to become a Director if elected at the AGM;
- to sell their shares on the open market (plc only);
- limited liability in the event of the business being wound up.

These last two rights are essential to encourage people to take risks by investing in businesses.

Workforce If workers are poorly paid, if conditions of work are poor, if they are not fairly treated and if they do not feel secure in their jobs, then there will be consequences for the business which will certainly damage the interests of shareholders. Among these consequences may be:

- industrial action;
- poor productivity;
- high absenteeism and labour turnover;
- legal intervention – for example, if wage rates below the minimum wage are paid or if safety conditions are not enforced, then legal action could follow which would damage the reputation of the company;
- negative customer reaction to poorly paid workers.

A combination of these pressures is nearly always likely to ensure that some or all of the workers' reasonable objectives are met. The extent to which their objectives are met will also depend on:

- profitability of the business;
- the culture of the organisation;
- availability of labour supply;
- union power within the firm;
- management attitudes and leadership style.

Customers Customers have buying objectives and although much is made of customer loyalty it does not take much to break it in most cases. If firms fail, in some way, to provide effectively for the needs of their customers then they will go elsewhere. Good examples of this exist in the retail sector. The decline in market share of Sainsbury in the UK can be traced back to their initial decision not to introduce a 'Customer Loyalty' card, as Tesco had done. By the time Sainsbury's management had reacted to the loss of market share it was too late – Tesco have not since been overtaken in this market. Similarly, the failure in 2000 of Marks and Spencer to update their clothing styles led to a dramatic fall in sales and profitability.

These examples demonstrate the power of consumer influence and the link between this and the returns to shareholders.

Lenders – or loan creditors Most businesses borrow. For some it is the daily working capital needs of an overdraft facility. For others it is the need to borrow long term to finance capital spending. These creditors demand as much security as possible for the loan, to ensure that it will be repaid and that interest payments will be made as agreed with the borrower. They will be particularly concerned with the liquidity of the business, but conflict can arise because a company with large liquid resources is not using them profitably. The greater the security given of paying back a loan through liquid assets the less return will be made from those assets.

Community Often, local communities have a two-sided view of business activity. Communities need the employment and spending power which business can bring to a region. The impact of employment and the incomes generated from it will have a positive effect on the living standards in the area. However, business activity tends to lead to external effects that can adversely effect the community. These effects can range from increased traffic congestion and associated dangers to pollution, for example the discharge of waste into rivers and local tips. Planning authorities that can give or refuse planning permission for business developments have to weigh up the positive and negative effects on the local community. They may insist on changes to original plans which make a particular business proposal less profitable – but more acceptable to the community. Clever management can turn this to their advantage, however. By claiming that the most environmentally friendly option has been accepted they may gain good publicity and wider acceptance by customers and residents alike.

Berkhamstead town centre. Traffic congestion is an increasing problem for many town centres

Government The Government has its own objectives which can greatly influence the policies it adopts towards business activity. These objectives include, or relate to:

- management of the economy;
- ensuring the observance of existing laws;
- introducing new laws in response to the needs of the population;
- improving living standards whilst protecting the environment;
- raising tax revenue;
- spending on Government programmes, such as education, health, roads, etc.;
- maintaining competitive conditions in industry for the benefit of consumers.

In pursuing these and other objectives, the Government uses persuasion and support, but in the last resort it is able to pass laws for the changes it requires. In this way, it is able to achieve its objectives in ways not open to businesses or individuals. Business activity may have to be adjusted to ensure that these new laws or controls are complied with. One such area of state legal involvement is in the area of 'competition policy'. The following Activity deals with how the US authorities deal with this issue.

Activity

Microsoft is the world's largest manufacturer of computer software. In effect, it has a monopoly of the industry and it has been accused of abusing its market power. Read these two articles and tackle the exercises that follow.

Case study – Microsoft defiant as shock waves hit shares

Bill Gates remained defiant in the face of a court ruling on Monday that his software behemoth, Microsoft, violated free-competition laws to squash its Silicon Valley rivals.

The ruling prompted meltdown in technology shares as investors ran scared, triggering a sell-off on Wall Street.

There were calls on the courts yesterday to take the harshest steps possible against Microsoft. 'The judge has laid the foundation for the break-up of Microsoft,' the consumer advocate Ralph Nader commented. 'Anything less than that will be like a thundering elephant emitting the squeak of a mouse.'

But Mr Gates, in an interview with the BBC, seemed sure that would not happen. 'I don't think any extreme remedy such as a break-up is at all consistent with what the court put forward,' he said. Insisting that Microsoft would prevail on appeal, he added: 'Common sense stands on our side.'

Microsoft shares continued to suffer a battering, by midday sinking an additional $\$2^5/_8$ to \$88.

Most of Microsoft's Silicon Valley rivals, some of whom were instrumental in triggering the case, were celebrating the ruling. 'We've been vindicated,' said James Barksdale, founder of Netscape. 'The ruling is great for consumers and for people who use technology.'

Source: David Usborne, *Independent*, 5 April 2000.

Case study – Microsoft ordered to split in two

A US federal judge yesterday ordered Microsoft to be split in two and imposed immediate sweeping curbs on its business practices in the biggest anti-monopoly break-up since AT&T in 1982.

Judge Thomas Penfield Jackson condemned Microsoft as 'untrustworthy' and likely to repeat its monopoly abuses. Siding with the US Justice Department and 17 states, the judge said Microsoft's break-up would 'revive competition'.

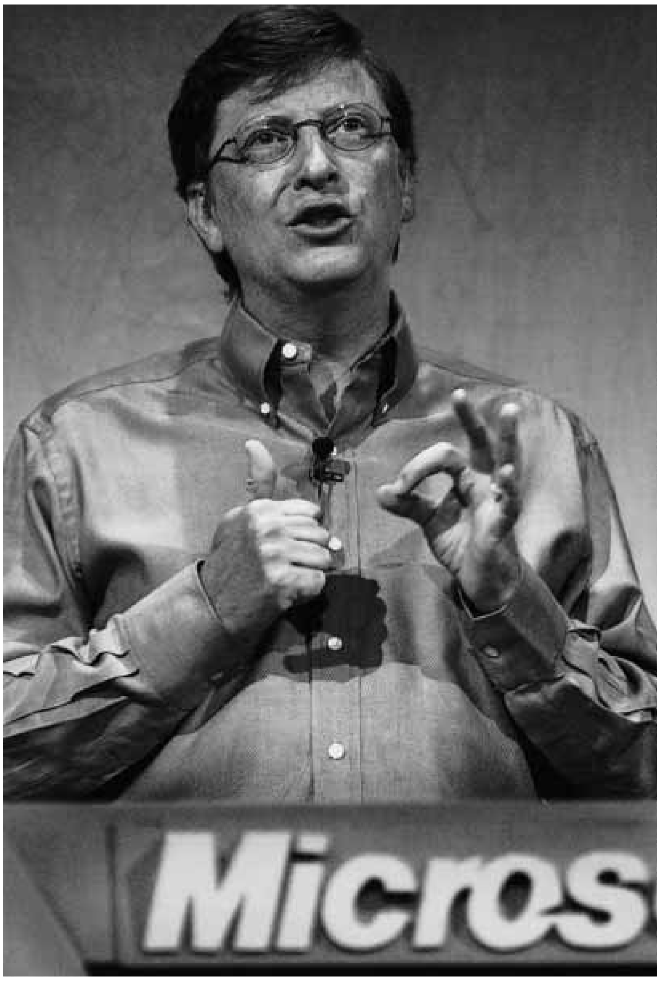
Unless it stages a successful appeal, Microsoft will be split into two parts – an operating systems business, managing Windows, and an applications business, managing other products including its Office package of business software.

'One Microsoft is critical to our efforts,' Bill Gates, Microsoft Chairman, said. 'We are planning some exciting projects . . . that require contributions from all parts of Microsoft.' Judge Jackson's ruling begins the formal process of break-up immediately, forcing Microsoft to file detailed plans for its own demise within four months.

The Judge's break-up order marks a resounding defeat for Microsoft after a two-year fight with the US government. Microsoft believes it was denied a fair hearing from Judge Jackson and has planned for an appeal from the earliest days of its trial in October 1998.

Joel Klein, head of the anti-trust division at the Justice Department, said yesterday: 'After the break up I expect both companies will be vibrant, strong and successful firms. They will have every incentive to compete vigorously with one another and with others. That competition will benefit America's consumers and the entire economy.'

Source: Richard Wolffe, Tom Foremski and Christopher Grimes, *Financial Times*, 5 April 2000.



(a) What benefits might the shareholders of Microsoft have gained from its monopoly position?
(b) Examine why the US Courts, under laws passed by the US Government, decided that consumer objectives would be served by the break-up of the monopoly.
(c) Discuss whether such action is desirable for the economy of the country.
(d) In the UK 'Competition Policy' does not allow for the break up of monopolies. How might the actions of Microsoft have been controlled if it was a UK-based company?

Bill Gates, Microsoft Chairman. *Source*: Popperfoto/Reuters.

Conclusion

As much as a business might try, it cannot completely satisfy all of its stakeholders all of the time. Every time a company attempts to satisfy the objectives of other interest groups it is likely, in the short term at least, to reduce rewards to shareholders. On the positive side, however, there are instances where:

- concerns for the needs of workers may increase their productivity;
- concerns for the community will increase customer loyalty and bring in new customers;
- ethical and environmentally friendly behaviour attracts customers and reduces the risk of legal action;
- a good reputation for customer care and ethical standards will attract the best workers.

Over-to-you

Short answer questions

1 What is the purpose of a mission statement?
2 What are often considered to be the practical limitations of mission statements?
3 State four factors that would help to ensure that corporate objectives were effective in assisting a business to achieve its aim.
4 Explain, with examples, what is meant by 'the conflict of stakeholder objectives'.
5 Why might short-term profit maximisation not be an appropriate objective for a business?
6 Explain what you understand by 'business culture'.
7 Discuss the factors that normally underpin the culture of a large established business.
8 Why should departmental objectives be co-ordinated?
9 What is meant by 'Management by Objectives'?
10 Give an example of a business strategy and outline how it might have been influenced by the four factors influencing business strategy.

Discover and learn

1 Read the case study below and tackle the exercises that follow.

Case study – The George Hotel

The George Hotel had been a family owned business for many years. Mike Perkins had decided to sell the business only after serious discussion with other family shareholders. It was becoming apparent that the long-established aim of the business to retain independence and to provide a reasonable income to all owners was conflicting with the need to compete more effectively in the hotel and conference market. Substantial investment was needed to bring the hotel up to the latest health and safety rules and to improve upon its rather faded and old-world image. The family was not prepared to invest the sums involved as they did not want to take in new shareholders and lose control. In addition, the extra time needed to both manage the new building works and the larger hotel complex was a deterrent to the managers of the hotel.

After the hotel was sold to the International Hotels group the nature of the business changed almost immediately. Several staff members lost their jobs and new staff were recruited on a part-time and short-term contract basis. A rebuilding programme doubled the size of the hotel and prices increased substantially.

(a) Why were the original owners of the hotel not interested in expanding or updating the hotel?
(b) Consider the impact of the takeover on at least two stakeholder groups and on the hotel's objectives.
(c) To what extent should the owners of the hotel take social and environmental issues into account when setting objectives?

2 Read the newspaper articles on Laporte Industries – a specialist chemicals business and tackle the exercises that follow.

Case study

Laporte sells non-core businesses

Laporte, the UK speciality chemicals group, has sold non-core businesses accounting for more than half its turnover to Kohlberg Kravis Roberts, the private equity investor, for £810m.

Laporte is disposing of companies that make the stripe in toothpaste and the gas that gives the bounce to high-tech trainers. It is remaining in a range of more complex chemicals used by the pharmaceutical industry to combat viral infections and cancer and to provide crop protection.

The sale ends a five-year programme initiated by Jim Leng, chief executive, to get out of low-margin consumer products and other chemicals to concentrate on speciality organic products. In spite of Mr Leng's efforts, Laporte struggled to overcome the strength of sterling, consolidation among customers and rivals and a sector out of favour with investors.

Mr Leng said the sale was 'the final significant step in the reshaping of Laporte', adding 'We think we have been bold but measured. It is frustrating to see your profits and margins rising while you share price falls.'

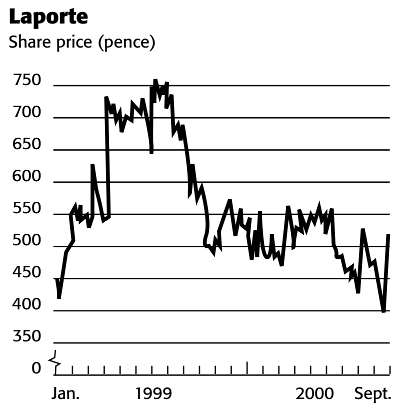
Laporte will return £200m to shareholders and will still have £53m cash that could fund acquisitions worth up to £250m.

Laporte's shares rose 84p or 20 per cent to 508¾p yesterday – still only two-thirds of the 773p level of October 1 1995, the month Mr Leng took over.

The sale leaves Laporte more focused but, with sales of £400m and 2 per cent of the fragmented global fine chemicals market, it would be an attractive takeover target.

The company was subject to a bid approach in April 1999, thought to be from Clariant, the Swiss chemicals group, which went on to buy UK chemicals group BTP in February.

The businesses being sold by Laporte are in pigments and additives, compounds and electronics, water technology and timber. They employ 3,000 people and made an operating profit before exceptional items of £83m on turnover of £494m in the year ended December 31. They had net assets of £233m.



Source: Primark Datastream

Despite the latest disposals the group may be vulnerable to a bid

When Jim Leng became chief executive of Laporte five years ago, one of the company's products was a cat-litter made from clay and branded 'Cassius' after the former world heavyweight boxing champion.

'We were chemists selling cat-litter,' Mr Leng recalled yesterday, a rising note of incredulity in his voice. Laporte had diversified into that market after originally making the clay to clarify edible oils. 'We just followed the product,' Mr Leng said.

The changes since made have been aimed at taking Laporte progressively upmarket and away from the final consumer to pharmaceutical companies and other industrial processors.

In the 15 years before Mr Leng's arrival, the previous management had bought 114 businesses, but failed to integrate them fully. They were managed regionally at a time when customers were demanding a single global point of contact.

Source: Charles Batchelor, *Financial Times*, 26 September 2000.

(a) What evidence is there that the aim of 'maximising returns to shareholders' was not being achieved?

(b) Explain how the future success of the company might be assisted by the strategy of selling 'non-core businesses'.

(c) Evaluate the likely reaction to this decision from the viewpoint of:

- the workforce of Laporte;
- the shareholders of Laporte.

Summary

In this chapter we have recognised that:

- Objectives are at the centre of all that a business does and arise, most importantly, from the expectations of owners and the culture of the business.
- In most organisations there is a hierarchy of objectives that is coherent and effectively communicated to all members of the organisation.
- Management by Objectives can be used to motivate human activity and to weld the workforce together into a cohesive team.
- All stakeholders in the business have objectives. These can conflict.
- Objectives are the framework within which business strategy, or long-term plan, is developed and therefore the framework for all that follows in this book.

Key words

Definitions of these key words/terms can be found in the Glossary on page 199.

business strategy
corporate culture
corporate objectives
Management by Objectives (MBO)
mission statement
people culture
profit maximisation
stakeholder objectives
task culture