# The External Environment: Opportunities,

# Threats, Industry Competition, and Competitor Analysis

***Chapter Introduction:*** This chapter can be introduced with a general statement regarding the importance of understanding what is happening outside of the firm itself and how what is happening can affect the firm’s ability to achieve strategic competitiveness and earn above-average returns. This importance is illustrated by the *Opening Case*, which discusses the impact events in the external environment can have on a firm’s performance.

**OPENING CASE**

**The Coca-Cola Co and Pepsico: Rivals Competing in a Challenging Environment**

The opening case illustrates how both Coca-Cola and Pepsico can use information from the general environment to develop plans for the future. Rivalry between these two companies is intense and it plays out on a global stage. However, these companies have not followed identical paths. Pepsico is more diversified than Coca-Cola due to its presence in the snack food industry (Frito Lay). Coca-Cola has focused more on beverages, including juice and juice products, where it is the largest producer in the world. Changing environmental conditions are driving both companies’ evolution in terms of businesses they are competing in, products/services they are developing, and how they structure their value chains to achieve competitive advantage. Taken together, one can see that assessing the influence of factors in the general environment is important for planning for future success.

***Teaching Note*:** The opening case lays out how Coca-Cola and Pepsico use information from the general environment to make strategic decisions. The case provides a vehicle for discussing how the environment affects both corporate-level strategy and business-level strategy. As an opening discussion question, ask students to identify and discuss examples of how these companies might base their strategies on information from the general environment that is NOT included in the text. Are there other industries that they might want to get into? Are there other products/services that either company could develop to address changing conditions?

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| **1** | Explain the importance of analyzing and understanding the firm’s external environment. |  |

***Teaching Note:*** Given that the external environment will continue to change—and that change may be unpredictable in terms of timing and strength—a firm’s management is challenged to be aware of, understand the implications of, and identify patterns represented in these changes by taking actions to improve the firm’s competitive position, to improve operational efficiency, and to be effective global competitors.

External environmental factors—like war and political unrest, variations in the strength of national economies, and new technologies—affect firm growth and profitability in the US and beyond.

Environmental conditions in the current global economy differ from those previously faced by firms:

* Technological advances require more timely and effective competitive actions and responses.
* Rapid sociological changes abroad affect labor practices and product demand of diverse consumers.
* Governmental policies and laws affect where and how firms may choose to compete.
* Changes to nations’ financial regulatory systems.

Understanding the external environment helps build the firm’s base of knowledge and information that can be used to: (1) help build new capabilities and core competencies, (2) buffer the firm from negative environmental impacts, and (3) pursue opportunities to better serve stakeholders’ needs.

***Teaching Note:*** This section introduces definitions, *Figure 2.1* (which deals with the external environment), and the competitor/industry environment. Because of the chapter layout, it is best to delay a detailed presentation or discussion of the general environment until after discussing the external environmental analysis process because the characteristics of the general environment are presented in more detail later in the chapter.

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| **2** | Define and describe the general environment and the industry environment. |  |

***Teaching Note:*** The firm’s understanding of the external environment is matched with knowledge about its internal environment (discussed in Chapter 3) to form its vision, to develop its mission, and to take strategic actions that result in strategic competitiveness and above-average returns. This is an important point to make.

**THE GENERAL, INDUSTRY, AND COMPETITOR ENVIRONMENTS**

***FIGURE 2.1***

#### The External Environment

*Figure 2.1* illustrates the three components of a firm’s external environment and the elements or factors that are part of each component. They are:

**1.** The general environment

|  |  |  |
| --- | --- | --- |
| * Demographic | * Political/Legal | * Sociocultural |
| * Economic | * Technological | * Global * Physical |

**2.** The industry environment

|  |  |  |
| --- | --- | --- |
| * Threat of New Entrants | * Power of Buyers | * Power of Suppliers |
| * Intensity of Rivalry | * Product Substitutes |  |

**3.** The competitor environment

(***Note:*** These components of the external environment and their elements or factors and how they are related to each and to firm performance will be discussed in detail in later sections of the chapter.)

The ***general environment*** is composed of elements in the broader society that can indirectly influence an industry and the firms within the industry. But firms cannot directly control the general environment’s segments and elements.

***TABLE 2.1***

#### The General Environment: Segments and Elements

*Table 2.1* lists elements that characterize each of the seven segments of the general environment: demographic, economic, political/legal, sociocultural, technological, global, and physical. Each of these segments is discussed in more detail later in this chapter, following a discussion of the external environmental analysis process.

The ***industry environment*** is the set of factors—threat of new entrants, suppliers, buyers, product substitutes, and the intensity of rivalry among competitors—that directly influence a firm and its competitive decisions and responses.

***Competitor analysis*** represents the firm’s understanding of its current competitors. This understanding will complement information and insights derived from investigating the general and industry environments.

The following are important distinctions to make regarding different external analyses:

* Analysis of the general environment focuses on the future.
* Industry analysis focuses on factors and conditions influencing firm profitability within its industry.
* Competitor analysis focuses on predicting the dynamics of rivals’ actions, responses, and intentions.

Performance improves when the firm integrates the insights provided by analyses of the general environment, the industry environment, and the competitor environment.

***Teaching Note*:** It should be noted that, although firms cannot directly control the elements of the external environment, they may be able to influence, and will be influenced by, these factors.

The strategic challenge is to develop an understanding of the implications of these elements and factors for a firm’s competitive position. Processes and frameworks for the analysis of the external environment are provided in this chapter.

***Teaching Note:*** Global implications should be—and are—integrated into the discussion of the general environment whereas global issues related to a firm’s industry environment are integrated throughout the text. Chapter 8 covers this topic in detail.

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| **3** | Discuss the four activities of the external environmental analysis process. |  |

**EXTERNAL ENVIRONMENTAL ANALYSIS**

In addition to increasing a firm’s awareness and understanding of an increasingly turbulent, complex, and global general environment, external environmental analysis also is necessary to enable the firm’s managers to interpret information to identify opportunities and threats.

***Opportunities*** represent conditions in the general environment that may help a company achieve strategic competitiveness by presenting it with possibilities, whereas ***threats*** are conditions that may hinder or constrain a company’s efforts to achieve strategic competitiveness.

Information used to analyze the general environment can come from multiple sources: publications, observation, attendance at trade shows, or conversations with customers, suppliers, and employees of public-sector organizations. And this information can be formally gathered by individuals occupying traditional “boundary spanning” roles (such as a position in sales, purchasing, or public relations) or by assigning information-gathering responsibility to a special group or team.

***Teaching Note*:**According to a recent comment by an industry analyst from a national firm, the Internet is becoming an increasingly valuable source of data and information for analyzing the general environment. Showing students how to do this in class or via an assignment can be a very helpful exercise.

One strategy that firms can use to enhance their awareness of conditions in the external environment is to establish an analysis process involving scanning, monitoring, forecasting, and assessing (see Table 2.2).

***TABLE 2.2***

#### Parts of the External Environmental Analysis

*Table 2.2* identifies the four parts of the external environmental analysis: scanning, monitoring, forecasting, and assessing.

**Scanning**

***Scanning*** entails the study of all segments in the general environment. Firms use the scanning process to either detect early warning signals regarding potential changes or to detect changes that are already underway. In most cases, information and data being collected or observed are ambiguous, incomplete, and appear to be unconnected. Scanning is most important in highly volatile environments, and the scanning system should fit the organizational context (e.g., scanning systems designed for volatile environments are not suitable for firms competing in a stable environment).

***Teaching Note*:** Scanning may signal a future change in the needs and lifestyles of baby boomers as they approach retirement age. This may not only provide opportunities for financial institutions as they prepare for an increase in the number of retirees, but also may provide opportunities for packagers and marketers of retirement communities and other products specifically targeted to this segment.

The Internet provides significant opportunities to obtain information. For example, Amazon.com records significant information about individuals visiting its website, particularly if a purchase is made. Amazon then welcomes the individual by name when he or she visits the website again. It even sends messages to the individual about specials and new products similar to that purchased in previous visits. Additionally, many websites and advertisers on the Internet obtain information surreptitiously from those who visit their sites via the use of “cookies.”

**Monitoring**

***Monitoring*** represents a process whereby analysts observe environmental changes over time to see if, in fact, an important trend begins to emerge. The critical issue in monitoring is that analysts be able to detect meaning from the data and information collected during the scanning process. (Remind students that these data are generally ambiguous, incomplete, and unconnected.)

Effective monitoring requires the firm to identify important stakeholders. Because the importance of different stakeholders can vary over a firm’s life cycle, careful attention must be given to the firm’s needs and its stakeholder groups over time. Scanning and monitoring can also provide information about successfully commercializing new technologies.

**Forecasting**

The next step is for analysts to take the information and data gathered during the scanning and monitoring phases and attempt to project forward. ***Forecasting*** represents the process where analysts develop feasible projections of what might happen—and how quickly—as a result of the changes and trends detected through scanning and monitoring. Because of uncertainty, forecasting events and outcomes accurately is a challenging task.

**Assessing**

Assessing represents the step in the external analysis process where all of the other steps come together. The objective of ***assessing*** is to determine the timing and significance of the effects of changes and trends in the environment on the strategic management of a firm. Getting the strategy right will depend on the accuracy of the assessment.

***Teaching Note*:** It is good to alert students to the fact that a major challenge for managers and firms engaging in the process of external analysis is to recognize biases and assumptions that may affect the analysis process. This is important because these may limit the accuracy of forecasts and assessments. For example, managers may choose to disregard certain information, thus missing critical indicators of future environmental changes. Or, past experiences may prejudice the ways that opportunities or threats are perceived—if they are perceived at all. One solution might be to solicit multiple inputs so a single source is not able to manipulate the information and to seek frequent feedback regarding the accuracy or usefulness of forecasts and assessments.

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| **4** | Name and describe the general environment’s seven segments. |  |

**SEGMENTS OF THE GENERAL ENVIRONMENT**

As outlined in *Table 2.1*, the general environment consists of seven segments: demographic, economic, political/legal, sociocultural, global, technological, and the physical environment. The challenge is to scan, monitor, forecast, and assess all six segments of the general environment, focusing the primary effort on those elements in each segment of the general environment that have the greatest potential impact on the firm.

External analysis efforts should focus on segments most important to the firm’s strategic competitiveness to identify environmental changes, trends, opportunities, and threats that can be matched with the firm’s core competencies so that it can achieve strategic competitiveness and earn above-average returns.

**The Demographic Segment**

The demographic segment is concerned with a population’s size, age structure, geographic distribution, ethnic mix, and distribution of income.

***Teaching Note*:** Though each of the elements of this segment are discussed below, you might note that the challenge for analysts (and managers) is to determine what the changes that have been identified in the demographic characteristics or elements of a population imply for the future strategic competitiveness of the firm.

Population Size

Though population size itself may be important to firms that require a “critical mass” of potential customers, changes in the specific make-up of a population’s size may have even more critical implications. One of the most important changes in a population’s size is changes in a nation’s birth rate and/or family size, as well as demographic changes in the population of developed versus developing countries.

Age Structure

Changes in a nation’s birth rate or life expectancy can have important implications for firms. Are people living longer? What is the life expectancy of infants? These will impact the health care system (and firms serving that segment) and the development of products and services targeted to an older (or younger) population.

***Geographic Distribution***

Population shifts—as have occurred in the US—from one region of a nation to another or from metropolitan to non-metropolitan areas may have an impact on a firm’s strategic competitiveness. Issues that should be considered include:

* The attractiveness of a firm’s location may be influenced by governmental support, and a shrinking population may imply a shrinking tax base and a lesser availability of official financial support.
* Firms may have to consider relocation if tax demands require it.
* Advances in communications technology will have a profound effect on geographic distribution and the workforce.

Ethnic Mix

This reflects the changes in the ethnic make-up of a population and has implications both for a firm’s potential customers and for the workforce. Issues that should be addressed include:

* Will new products and services be demanded or can existing ones be modified?
* How will changes in the ethnicity of a population affect the composition of the workforce?
* Are managers prepared to manage a more culturally diverse workforce?
* How can the firm position itself to take advantage of increased workforce heterogeneity?

Income Distribution

Changes in income distribution are important because changes in the levels of individual and group purchasing power and discretionary income often result in changes in spending (consumption) and savings patterns. Tracking, forecasting, and assessing changes in income patterns may identify new opportunities for firms.

**The Economic Segment**

The ***economic segment*** of the general environment refers to the nature and direction of the economy in which a firm competes or may compete. Analysts must scan, monitor, forecast, and assess a number of key economic indicators or elements, including levels and trends of

* Inflation rates and interest rates
* Trade deficits and surpluses
* Budget deficits and surpluses
* Personal savings rates
* Business savings rates
* Gross domestic product
* Currency valuation
* Unemployment rates
* Energy and commodity prices

for both domestic and key international markets. In addition, the implications of changes and trends in the economic segment may affect the political/legal segment both domestically and in other global markets. This may be of critical importance as nations eliminate or reduce trade barriers and integrate their economies.

**The Political/Legal Segment**

The ***political/legal segment*** is the arena in which organizations and interest groups compete for attention, resources, and a voice in overseeing the body of laws and regulations guiding the interactions among nations as well as between firms and various local governmental agencies. In other words, this segment is concerned with how interest groups and organizations attempt to influence representatives of governments (and governmental agencies) and how they, in turn, are influenced by them. This segment is also concerned with the outcomes of legal proceedings in which the courts interpret the various laws and regulations.

Because of the influence that this segment can have on the nature of competition as well as on the overall profitability of industries and individual firms, analysts must assess changes and trends in administration philosophies regarding:

* Anti-trust regulations and enforcement
* Tax laws
* Industry deregulation
* Labor training laws
* Commitments to education
* Free trade versus protectionism

***Teaching Note:*** It would be good to comment (using examples from the text or examples that may be even more current) on strategies followed by firms as they attempt to manage or influence the political/legal segment.

* How can firms in the electric utility industry manage the costs of deregulation, including write-offs of inefficient plants? Who will pay these costs? Consumers? Governmental units? Stockholders? Bondholders?
* How can individual firms and industries manage the effects of free trade that will lower entry barriers for new, lower-cost competitors? How might firms position themselves to take advantage of emerging, free-market economies?
* What is likely to be the competitive impact of loosening governmental controls in the entertainment industry? In the telecommunications industry? What strategies can firms use to manage or influence deregulation to their advantage?

### The Sociocultural Segment

The ***sociocultural segment*** is concerned with different societies’ social attitudes and cultural values. This segment is important because the attitudes and values of society influence and thus are reflected in changes in a society’s economic, demographic, political/legal, and technological segments.

Analysts are especially cautioned to pay attention to sociocultural changes and effects that they may have on:

* Workforce composition, and the implications for managing, resulting from an increase in the number of women, and increased ethnic and cultural diversity
* Changes in attitudes about the growing number of contingency workers
* Shifts in population toward suburban life, and resulting transportation issues
* Shifts in work and career preferences, including a trend to work from home made possible by technology advances

**The Technological Segment**

As noted in many of the other segments of the general environment, and as discussed in Chapter 1 as a key driver of the new competitive landscape, technological changes can have broad effects on society. The ***technological segment*** includes institutions and activities involved with creating new knowledge and translating that knowledge into new outputs, products, processes, and materials.

Firms should pay careful attention to the technological segment, since early adopters can gain market share and above-average returns.

Important technology-related issues that might affect a broad variety of firms include:

* Increasing plant automation
* Internet technologies and their application to commerce and data gathering
* Uses of wireless technology

**The Global Segment**

Among the global factors that should be assessed are:

* The potential impact of significant international events such as peace in the Middle East or the recent entry of China into the WTO
* The identification of both important emerging global markets and global markets that are changing
* The trend toward increasing global outsourcing
* The differences between cultural and institutional attributes of individual global markets (the focus in Korea on *inhwa*, or harmony, based on respect for hierarchical relationships and obedience to authority; the focus in China on *guanxi*, or personal relationships; the focus in Japan on *wa*, or group harmony/social cohesion)
* Global market expansion opportunities
* The opportunities to learn from doing business in other countries
* Expanding access to the resources firms need for success (e.g., capital)

***Teaching Note:*** *Globalfocusing* is a cautious approach to globalization in which firms with a moderate level of international operations increase their internationalization by focusing on global niche markets (and/or limiting opertations/sales to one geographical region of the world). This approach allows firms to build on and use their core competencies while limiting their risks within the niche market.

**STRATEGIC FOCUS**

The Informal Economy: What It Is and Why It Is Important

The Strategic Focus introduces students to the informal economy – commercial activities that occur at least partly outside a governing body’s observation, taxation, and regulation. People choose to work in the informal economy because of choice or out of necessity. Evidence suggests that informal employment is linked to poor employment conditions and increased worker poverty. The informal economy accounts for varying degrees of activity from country to country, with activity in developing countries being much higher (up to 75%). Even in the U.S., it is estimated that the informal economy generates $2 trillion of annual economic activity. Two conditions significantly contribute to the informal economy - economic activity insufficient to create a significant number of jobs and governments’ inability to facilitate growth.

*Teaching Note*: Students should realize that the informal economy exists and that it does have the potential to impact firms in many industries. As students if they have every participated in the informal economy and the reason(s) for doing so. Ask them to identify some of the ways that the informal economy specifically impacts firms operating in the formal economy. Follow up by asking students to identify ways that firms in the formal economy are adapting to competition from informal economy organizations.

**The Physical Environment Segment**

The ***physical environment segment*** refers to potential and actual changes in the physical environment and business practices that are intended to positively respond to and deal with those changes. Ecological, social, and economic systems interact to influence what happens in this segment. Global warming, energy consumption, and sustainability are all examples of issues related to the physical environment.

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| **5** | Identify the five competitive forces and explain how they determine an industry’s profit potential. |  |

**INDUSTRY ENVIRONMENT ANALYSIS**

An ***industry*** is a group of firms producing products that are close substitutes for each other. As they compete for market share, the strategies implemented by these companies influence each other and include a broad mix of competitive strategies as each company pursues strategic competitiveness and above-average returns.

It should be noted that, unlike the general environment, which has an *indirect* effect on strategic competitiveness and firm profitability, the effect of the industry environment is more *direct*. Industry—and individual firm—profitability and the intensity of competition in an industry are a function of five competitive forces as presented in *Figure 2.2*.

***Figure Note*:** Students should refer to *Figure 2.2* as it provides a framework that can be used to analyze competition in an industry. A broader discussion of the five competitive forces and other factors follows *Figure 2.2*.

***FIGURE 2.2***

#### The Five Forces Model of Competition

The Five Forces Model of Competition indicates that these forces interact to determine the intensity or strength of competition, which ultimately determines the profitability of the industry.

* Threat of New Entrants
* Threat of Substitute Products
* Bargaining Power of Buyers (Customers)
* Bargaining Power of Suppliers
* Rivalry Among Competing Firms in an industry

Assessing the relative strength of the five competitive forces is important to a firm’s ability to achieve strategic competitiveness and earn above-average returns.

Viewed differently, competition should be seen as groupings of alternative ways that customers can obtain desired results. Thus, any analysis of an industry must expand beyond the traditional practice of concentrating on direct competitors to include *potential* competitors. For example:

* Suppliers can become competitors by integrating forward.
* Buyers or customers can become competitors by integrating backward.
* Firms that are not competitors today could produce products that serve as substitutes for existing products offered by firms in an industry, transforming themselves into competitors.

***Threat of New Entrants***

New entrants to an industry are important because with new competitors, the intensity of competitive rivalry in an industry generally increases. This is because new competitors may bring substantial resources into the industry and may be interested in capturing a significant market share. If a new competitor brings additional capacity to the industry when product demand is not increasing, prices that can be charged to consumers generally will fall. One result may be a decline in sales and lower returns for many firms in the industry.

***Teaching Note*:** To help students grasp the potential impact of new entrants on an industry, it is helpful to illustrate this effect by referring to a number of examples that may be familiar to them, such as:

* The transformation of the steel industry when mini-mills (such as Nucor and Birmingham Steel) entered the industry in competition with integrated domestic producers such as US Steel and Bethlehem Steel
* The impact of the increase in the number of cell phone providers on the cost of having a cell phone (and the long-range, potential impact on the cost of local telephone service)
* The increase in the number of Internet access providers and the effects of increased competition on such firms as CompuServe and America Online

The seriousness or extent of the threat of new entrants is affected by two factors: barriers to entry and expected reactions from—or the potential for retaliation by—incumbent firms in the industry.

***Barriers to Entry***

Barriers to entering an industry are present when entry is difficult or when it is too costly and places potential entrants at a competitive disadvantage (relative to firms already competing in the industry). Seven factors represent potentially significant entry barriers that can emerge as an industry evolves or might be explicitly “erected” by current participants in the industry to protect profitability by deterring new competitors from entry.

**Economies of Scale** refers to the relationship between quantity produced and unit cost. As the quantity of a product produced during a given time period increases, the cost of manufacturing each unit declines.

Economies of scale can serve as an entry barrier when existing firms in the industry have achieved these scale economies and a potential new entrant is only able to enter the industry on a small scale (and produce at a higher cost per unit).

Economies of scale can be overcome as a potential entry barrier by firms that produce multiple customized products or that enter an industry on a large-enough scale. New manufacturing technology facilitated by advanced information systems has allowed the development of “mass customization” in an increasing number of industries, and online ordering has enhanced the ability of customers to obtain customized products (often referred to as “markets of one”).

**Product Differentiation:** Customers may perceive that products offered by existing firms in the industry are unique as a result of service offered, effective advertising campaigns, or being first to offer a product of service to the market. If customers perceive a product or service as unique, they generally are loyal to that brand. Thus, new entrants may be required to spend a great deal of money over a long period of time to overcome customer loyalty to existing products.

Though new entrants may be able to overcome perceived uniqueness and brand loyalty, the cost of such strategies generally will be high: offering lower prices, adding additional features, or allocating significant funds to a major advertising and promotion campaign. In the short run, new entrants that try to overcome uniqueness and brand loyalty may suffer lower profits or may be forced to operate at a loss.

**Capital Requirements:** Firms choosing to enter any industry must commit resources for facilities—to purchase inventory, to pay salaries and benefits, etc. Though entry may seem attractive (because there are no *apparent* barriers to entry), a potential new entrant may not have sufficient capital to enter the industry.

**Switching Costs:** These are the one-time costs customers will incur when buying from a different supplier. They can include such explicit costs as retraining of employees or retooling of equipment as well as the psychological cost of changing relationships. Incumbent firms in the industry generally try to establish switching costs to offset new entrants that try to win customers with substantially lower prices or an improved (or, to some extent, different) product.

**Access to Distribution Channels:** As existing firms in an industry generally have developed effective channels for distributing products, these same channels may not be available to new firms entering an industry. Thus, access (or lack thereof) may serve as an effective barrier to entry.

This may be particularly true for consumer nondurable goods (because of the limited amount of shelf space available in retail stores) and in international markets. In the case of some durable goods or industrial products, to overcome the barrier, new entrants must again incur costs in excess of those paid by existing firms, either through lower prices or price breaks, costly promotion campaigns, or advertising allowances. New entrants may have to incur significant costs to establish a proprietary distribution channel. As in the case of product differentiation or uniqueness barriers, new entrants may suffer lower profits or operate at a loss as they battle to gain access to distribution channels.

**Cost Disadvantages Independent of Scale:** Existing firms in an industry often are able to achieve cost advantages that cannot be *costlessly* duplicated by new entrants (i.e., other than those related to economies of scale and access to distribution channels). These can include proprietary process (or product) technology, more favorable access to or control of raw materials, the best locations, or favorable government subsidies.

Potential entrants must find ways to overcome these disadvantages to be able to effectively compete in the industry. This may mean successfully adapting technologies from other industries and/or non-competing products for use in the target industry, developing new sources of raw materials, making product (or service) enhancements to overcome location-related disadvantages, or selling at a lower price to attract customers.

**Government Policy:** Governments (at all levels) are able to control entry into an industry through licensing and permit requirements. For example, at the firm level, entry into the banking industry is regulated at both the federal and state levels, whereas liquor sales are regulated at the state and local levels. In some cases, state and/or federal licensing requirements limit entry into the personal services industry (securities sales and law), while in others only state requirements may limit entry (barbers and beauticians).

***Teaching Note*:** Students should be reminded of the monopolistic nature (on a market-by-market basis) of the public utility industry, including local telephone service, water, electric power, and cable television. The “regulated monopolies” will provide helpful illustrations to make sense of this section.

***Expected Retaliation***

Even if a firm concludes that it can successfully overcome all of the entry barriers, it still must take into account or anticipate reactions that might be expected from existing firms.

Strong retaliation is likely when existing firms have a heavy investment in fixed assets (especially when there are few alternative uses for those assets) or when industry growth is slow or declining. Retaliation could take the form of announcements of anticipated future investments to increase capacity, new product plans, price-cutting or a study to assess the impact of lower prices (this might imply price-cutting as a “promised” entry barrier-creation strategy by existing firms).

Small entrepreneurial firms can avoid retaliation by identifying and serving neglected market segments. For example, Honda first entered the US market by concentrating on small-engine motorcycles, a market that firms such as Harley-Davidson ignored. After consolidating its position, Honda went on the offensive by introducing larger motorcycles and competing in the broader market.

**Bargaining Power of Suppliers**

The bargaining power of suppliers depends on suppliers’ economic bargaining power relative to firms competing in the industry. Suppliers are powerful when firm profitability is reduced by suppliers’ actions. Suppliers can exert their power by raising prices or by restricting the quantity and/or quality of goods available for sale.

Suppliers are powerful relative to firms competing in the industry when:

* The supplier segment of the industry is dominated by a few large companies and is more concentrated than the industry to which it sells
* Satisfactory substitute products are not available to industry firms
* Industry firms are not a significant customer group for the supplier group
* Suppliers’ goods are critical to buyers’ marketplace success
* Effectiveness of suppliers’ products has created high switching costs for buyers
* Suppliers represent a credible threat to integrate forward into the buyers’ industry, especially when suppliers have substantial resources and provide highly differentiated products

In the airline industry, suppliers’ bargaining power is changing. There are few suppliers, but demand for the major aircraft is also low. Boeing and Airbus compete strongly for most orders of major aircraft. However, China recently announced plans to enter the market by building large commercial aircraft, significant in a country that is projected to purchase thousands.

**Bargaining Power of Buyers**

While firms seek to maximize their return on invested capital, buyers are interested in purchasing products at the lowest possible price (the price at which sellers will earn the lowest acceptable return). To reduce cost or maximize value, customers bargain for higher quality or greater levels of service at the lowest possible price by encouraging competition among firms in the industry.

Buyer groups are powerful relative to firms competing in the industry when:

* Buyers are important to sellers because they purchase a large portion of the supply industry’s total sales
* Products purchased from a supply industry represent a significant portion of the seller’s annual revenues
* Buyers are able to switch to another supplier’s product at little, if any, cost
* Suppliers’ products are undifferentiated and standardized, and the buyers represent a real threat to integrate backward into the suppliers’ industry using resources or expertise

Armed with greater amounts of information about the manufacturer’s costs and the power of the Internet as a shopping and distribution alternative, consumers appear to be increasing their bargaining power in many industries. One reason for this shift is that individual buyers incur virtually zero switching costs when they decide to purchase from one manufacturer rather than another or from one dealer as opposed to a second or third one.

**Threat of Substitute Products**

All firms must recognize that they compete against firms producing ***substitute products***, those products that are capable of satisfying similar customer needs but come from outside the industry and thus have different characteristics. In effect, prices charged for substitute products represent the upper limit on the prices that suppliers can charge for their products.

The threat of substitute products is greatest when:

* Buyers or customers face few, if any switching costs
* Prices of the substitute products are lower
* Quality and performance capabilities of substitutes are equal to/greater than those of the industry’s products

Firms can offset the attractiveness of substitute products by differentiating their products in ways that are perceived by customers as relevant. Viable strategies might include price, product quality, product features, location, or service level.

***Examples of Traditional and Substitute Products and Their Usage***

***Traditional product Substitute product*** ***Usage***

Overnight delivery Fax machines/e-mail Document delivery

Sugar NutraSweet Sweetener

Glass Plastic Containers

Coffee Tea Beverages

Paper bags Plastic bags Flexible packaging

**Intensity of Rivalry Among Competitors**

The intensity of rivalry in an industry depends on the extent to which firms in an industry compete with one another to achieve strategic competitiveness and earn above-average returns because success is measured relative to other firms in the industry. Competition can be based on price, quality, or innovation.

Because of the interrelated nature of firms’ actions, action taken by one firm generally will result in retaliation by competitors (also known as competitive response). In addition to actions and reactions that result as firms attempt to offset the other competitive forces in the industry—threat of new entry, power of suppliers and buyers, and threat of substitute products—the intensity of competitive rivalry is also a function of a number of other factors.

***Numerous or Equally Balanced Competitors***

Industries with a high number of firms can be characterized by intense rivalry when firms feel that they can make competitive moves that will go unnoticed by other firms in the industry. However, other firms will generally notice these moves and offer countermoves of their own in response. Patterns of frequent actions and reactions often result in intense rivalry, such as in local restaurant, retailing, or dry-cleaning industries.

Rivalry also is intense in an industry that has only a few firms of equivalent resources and power. The firms’ resource bases enable each to take frequent action to improve their competitive positions which, in turn, produce a reaction or countermove by competitors. Battles for market share in the fast food industry between McDonald’s and Burger King; in the automobile industry between such firms as General Motors, Ford, and Toyota; and in athletic shoes between Nike and Reebok are examples of intense rivalry between relatively equivalent competitors. Of course, Boeing versus Airbus is an especially useful example.

***Slow Industry Growth***

When a market is growing at a level where there seem to be “enough customers for everyone,” competition generally centers around effective use of resources so that a firm can effectively serve a larger, growing customer base. Because of sufficient growth in the market, firms do not concentrate on taking customers away from other firms.

The intensity of competition often results in a reduction in industry profitability as observed in the fast-food industry with the battle for a slower growing traditional, US customer base between McDonald’s, Burger King, and Wendy’s. The intensity of competition can be illustrated by the various competitive strategies followed by firms in the fast-food industry:

* Rapid and continuous introduction of new products and new packaging schemes
* The introduction of innovative-pricing strategies
* Product and/or service differentiation

***High Fixed Costs or High Storage Costs***

When an industry is characterized by high fixed costs relative to total costs, firms produce in quantities that are sufficient to use a large percentage, if not all of their production capacity so that fixed costs can be spread over the maximum volume of output. Though this may lower per unit costs, it also can result in excess supply if market growth is not sufficient to absorb the excess inventory. The intensity of competitive rivalry increases as firms use price reductions, rebates, and other discounts or special terms to reduce inventory as observed in the automobile industry from the 1980s to the present.

High storage costs, especially those related to perishable or time-sensitive products (such as fruits and vegetables) also can result in high levels of competitive intensity as such products rapidly lose their value if not sold within a given time period. Pricing strategies often are used to sell such products.

***Lack of Differentiation or Low Switching Costs***

Products that are not characterized by brand loyalty or perceived uniqueness are generally viewed by buyers as commodities. For such products, industry rivalry is more intense and competition is based primarily on price, service, and other features of interest to consumers.

Switching costs can be used to decrease the likelihood that customers will switch to competitors’ products. Products for which customers incur no or few switching costs are subject to intense price- and service-based competition, similar to undifferentiated products.

***High Strategic Stakes***

The intensity of competitive rivalry increases when success in an industry is important to a large number of firms (such as the domestic airline industry following deregulation). For example, the success of a diversified firm may be important to its effectiveness in other industries, especially when the firm is in interdependent or related industries.

Geographic stakes may also be high. The importance of geographic stakes can be illustrated by the intense rivalry in the US automobile industry as Japanese manufacturers recognized the strategic importance of a US marketplace presence and US manufacturers responded.

***High Exit Barriers***

***Exit barriers***—created by economic, strategic, and emotional factors that cause companies to remain in an industry even though the profitability of doing so is in question—also can increase the intensity of competition in an industry. The higher the barriers to exit, the greater the probability that competitive actions and reactions will include price cuts and extensive promotions.

Some sources of exit barriers include:

* Investments in *specialized assets*, or assets whose value is linked to use in a particular industry or location, with little or no value as salvage or in other uses
* *Fixed costs of exit*, such as labor agreements or a requirement to repay federal, state, or local aid packages
* *Strategic relationships*, interdependencies within the organization (e.g., shared facilities, market access)
* *Emotional barriers*, such as loyalty to employees or fear for one’s own career
* *Government and/or social restrictions* based on concern for job losses or the economic impact of exit

***Teaching Note*:** One way to get students to recognize the industry forces Porter presents is to allow them to learn about a given industry and report on these forces as they see them and assess their strength. For example, one adopter of the text shows students the first segment of a PBS video series by Daniel Yergin called “The Prize.” This one-hour video profiles the formation of the oil industry and its rapid transformation in the early days. Students are asked to identify the many illustrations of “Porter’s Five Forces in action” as they watch the video (e.g., profits were much greater early in the first part of the industry’s first decade than in the last years of that period because barriers to entry were low and the rapid influx of new entrants expanded supply and depressed prices). As an incentive for diligent observation, the student who identifies the greatest number of legitimate illustrations is rewarded with bonus points.

**Interpreting Industry Analyses**

Effective industry analyses are products of careful study and interpretation of data from multiple sources. Because of globalization, international markets and rivalry must be included in the firm’s analyses; in fact, research shows international variables may have more impact on strategic competitiveness than domestic ones, in some cases.

Following a study of the five industry forces, the firm has the insights required to determine an industry’s attractiveness in terms of the potential to earn adequate or superior returns on its invested capital. In general, the stronger the competitive forces, the lower the profit potential for an industry’s firms. An unattractive industry has low entry barriers, suppliers and buyers with strong bargaining positions, strong competitive threats from product substitutes, and intense rivalry among competitors, which make it difficult for firms to achieve strategic competitiveness and earn above-average returns. An attractive industry has the mirror image of these features and offers little potential for favorable performance.

Characteristics of attractive and unattractive industries are summarized below.

***Industry Characteristic Attractive Unattractive***

Threat of New Entry Low High

Bargaining Power of Suppliers Low High

Bargaining Power of Buyers Low High

Threat of Substitute Products Low High

Intensity of Competitive Rivalry Low High

***Teaching Note*:** It may be helpful to explain that the relationship between the strength of industry forces and prices/profits in the industry is an inverse one. When the forces are strong, prices/profits in the industry tend to be low, whereas weak forces usually lead to higher prices/profits. The mental image is one of a playground “teeter-totter” or balance scale.

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| **6** | Define strategic groups and describe their influence on firms. |  |

**Strategic Groups**

As implied by the previous discussion, not all firms in an industry may adopt the same strategies in their quest for strategic competitiveness and above-average returns. However, many firms in an industry may follow similar strategies. These firms are generally classified as ***strategic groups***, or groups of firms in an industry following the same or similar strategies along the same strategic dimensions.

Membership in a particular strategic group is determined by the essential characteristics of a firm’s strategy, which may include the

* Extent of technological leadership
* Degree of product quality
* Pricing policies
* Choice of distribution channels
* Degree and type of customer service

***Teaching Note*:**It may be helpful to assign students (or student teams) the task of developing a strategic group map of an industry with which they are familiar (e.g., fast food, automobile manufacturing, computers, or the financial services industry).

***Teaching Note*:** Many strategy experts believe that the strategic group concept provides a useful tool for analyzing an industry from firm-specific perspectives in order to learn how to compete successfully. However, some critics indicate that there is no convincing evidence that (1) strategic groups exist or (2) that firm performance is dependent on membership in a particular group. Others contend that little additional understanding can be gained from industry analysis by looking at strategic groups, but recent research provides some evidence to support the usefulness of this analysis.

The strategic group concept can be useful in analyzing the competitive structure of an industry and can serve as a framework for assessing competition, positioning alternatives, and potential profitability of firms in an industry.

High mobility barriers, high rivalry, and low resources among the firms within an industry will limit the formation of strategic groups. However, research suggests that once formed, strategic group membership remains relatively stable over time, making analysis easier and more useful.

Use of the strategic group concept requires that analysts be aware of several implications:

* A firm’s major or primary competitors are those in its strategic group, thus competitive rivalry within the strategic group is expected to be more intense than rivalry with other firms in the industry.
* The relative strengths of the five competitive forces will differ among groups, thus firms in different groups may adopt different competitive strategies.
* The closer the strategic groups on the relevant dimensions, the greater the likelihood of their rivalry.

**STRATEGIC FOCUS**

**German Performance/Luxury Cars: If You Have Seen One, Have You Seen Them All?**

The Strategic Focus profiles the strategic group consisting of Audi, BMW, and Mercedes-Benz. There are many similarities among these competitors, including markets served (target customers and geographic emphasis) and the many dimensions of performance/ luxury of the products themselves. Rivalry is intense among this group and, as is often the case with strategic groups, has remained stable over a long period of time.

***Teaching Note*:** The Strategic Focus provides a good discussion vehicle for competitor analysis with a strategic group (and within a very turbulent industry that is continually being redefined as environments change and new technologies emerge). Ask students to compare the Audi, BMW, and Mercedes-Benz brands and the customers that each is vying for. How do these firms try to position themselves to appeal to buyers by delivering value to a very demanding segment of the market?

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| **7** | Describe what firms need to know about their competitors and different methods (including ethical standards) used to collect intelligence about them. |  |

**Competitor Analysis**

Competitor analysis represents a necessary adjunct to performing an industry analysis. An industry analysis provides information regarding potential sources of competition (including the possible strategic actions and reactions and effects on profitability for all firms competing in an industry). However, a structured competitor analysis enables the firm to focus its attention on those firms with which it will *directly* compete, and is especially important when a firm faces a few powerful competitors.

Competitor analysis is interested ultimately in developing a profile on how competitors might be expected to respond to a firm’s strategic moves. The process involves developing answers to a series of questions about competitors such as:

* Competitors’ future objectives
* Competitors’ current strategy
* Competitors’ assumptions about the industry
* Capabilities, as shown by competitors’ strengths and weaknesses

Competitor intelligence is critical to competitor analysis because it helps a firm understand competitors’ intentions and the strategic implications resulting from them. Competitor intelligence is performed both for domestic and international competitors.

*FIGURE 2.3*

Competitor Analysis Components

Figure 2.3 shows how the components of competitor analysis help the firm prepare an anticipated response profile for each competitor.

Components Response

Future Objectives What will our competitors do in the future?

Current Strategy Where do we hold an advantage over our competitors?

Assumptions How will this change our relationship with our

Capabilities competitors?

***Teaching Note*:** To help students understand the usefulness of competitor analysis, have them develop a profile of another university or college, assume the role of a Pepsi product manager and develop a competitive profile of Coca-Cola, or take the perspective of Intel and describe AMD’s competitive characteristics. A specific case that contains the bulk of the required information also could be used to perform an in-class competitor analysis.

Another significant component are the **complementors** of a firm’s products and strategy. These are the networks of companies that sell goods and services compatible with the firms own product or service.

**ETHICAL CONSIDERATIONS**

A major concern of many managers is the methods used to gather data on competitors, a process generally referred to as ***competitor intelligence***. The illustration of Microsoft’s struggle to understand Google is especially helpful in explaining this concept. It is a great managerial challenge to ensure that all data and information related to competitors are gathered both legally and ethically. This is important because many employees may feel pressure to rely on techniques that are questionable from an ethical perspective to gather information that may be valuable to their firm, especially if they perceive value to their own careers from successfully obtaining such information.

It seems obvious that information that (1) is either publicly available (annual reports, regulatory filings, brochures, advertising and promotional materials) or (2) is obtained by attending trade shows and conventions can be used without ethical or legal implications. However, information obtained illegally (as a result of activities such as theft, blackmail, or eavesdropping) cannot—or, at least, should not—be used since its use is unethical as well as illegal.

***Teaching Note*:** It might be useful and insightful to require students to develop (and bring to class) their own lists of questionable intelligence-gathering techniques or formulate an argument as to the circumstances (if any) under which these techniques might be considered ethical. This could make for a lively discussion of the issue.

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|  | **ANSWERS TO REVIEW QUESTIONS** |  |

1. Why is it important for a firm to study and understand the external environment?

The external environment influences the firm’s strategic options as well as the decisions made in light of them. The firm’s understanding of the external environment is especially useful when it is matched with knowledge about its internal environment. Matching the conditions of the two environments is the foundation the firm needs to form its vision, mission, and to take strategic actions in the pursuit of strategic competitiveness and above-average returns. The importance of understanding the external environment is further underscored by the fact that the environmental conditions facing firms in the global economy of the 21st century differ from those firms faced previously. For example, technological changes and the explosion in information gathering and processing capabilities demand more timely and effective competitive actions and responses. The rapid sociological changes occurring in many countries affect labor practices and the nature of products demanded by increasingly diverse consumers. Governmental policies and laws affect where and how firms choose to compete. Competitive advantage goes to those firms who know their external environment and plan their strategies so they are relevant to these conditions.

2. What are the differences between the general environment and the industry environment? Why are these differences important?

The *general environment* represents those elements in the broader society that can influence all (or most) industries and the firms that compete in those industries; it represents elements or segments that firms cannot directly control. The general environment is composed of the following segments: demographic, economic, political/legal, sociocultural, technological, and global.

The industry environment is the constellation of factors that directly influences a firm and its competitive actions and responses. Firms are influenced by these factors and should attempt to establish a position in the industry that enables the firm to favorably influence the factors or to successfully defend against the factors’ influence. These factors are: threat of new entrants, bargaining power of suppliers, bargaining power of buyers, threat from substitute products, and intensity of rivalry among competitors.

3. What is the external environmental analysis process (four parts)? What does the firm want to learn when using this process?

The environmental analysis process represents an organized attempt by the firm to better understand turbulent, complex, and global environments. This is achieved by *scanning* (studying all segments of the general environment to identify existing or potential changes), *monitoring* (observing the pattern of changes over time in an attempt to detect meaning or identify trends), *forecasting* (developing feasible projections of what might happen, and how quickly, as a result of changes and trends identified from scanning and monitoring activities) and *assessing* (determining the timing and significance of environmental changes and trends on the strategic management of the firm). Stated differently, this analysis should examine and process external data on a continuous basis.

An important objective of the environmental analysis process is to identify potential threats (conditions that may hinder the firm’s efforts to achieve strategic competitiveness) and opportunities (that may assist or help the firm in its efforts to achieve strategic competitiveness).

4. What are the seven segments of the general environment? Explain the differences among them.

The *demographic segment* is concerned with characteristics of the population or society that makes up the general environment. Characteristics of interest are size, age, structure, geographic distribution, ethnic mix, and income distribution.

The *economic segment* refers to the nature and direction of the economy in which a firm competes or may compete in the future. Important characteristics include inflation and interest rates, trade deficits (or surpluses), budget deficits (or surpluses), individual and business savings and investment rates, and gross domestic product.

The *political/legal segment* is the arena in which organizations and interest groups compete for attention, resources, and a voice in overseeing the body of laws and regulations guiding interactions between nations. In other words, this segment is concerned with how firms and other organizations attempt to influence government and how governmental entities in turn influence them.

The *sociocultural segment* is concerned with the social attitudes and cultural values of different societies.

The *technological segment* is made up of the institutions and activities involved with creating new knowledge and translating that knowledge into new outputs, products, processes, or materials.

The *global segment* includes relevant new global markets and existing ones that are changing, important international political events, and critical cultural and institutional characteristics of relevant global markets. This segment recognizes that firms now compete in a competitive landscape where both competitors and customers are global, due in part to the rapid diffusion of both information and technology. Competitors will no longer be domestic; they can originate from industrialized, newly industrialized, or emerging countries. Customer demands and expectations have changed; they are based on an ever-increasing awareness of global products and services.

The *physical environment segment* refers to potential and actual changes in the physical environment and business practices that are intended to positively respond to and deal with those changes. Ecological, social, and economic systems interact to influence what happens in this segment. Global warming, energy consumption, and sustainability are all examples of issues related to the physical environment.

5. How do the five forces of competition in an industry affect its profit potential? Explain.

An industry’s competitive intensity and profit potential can be determined by the relative strengths of five competitive forces. This model of industry competition recognizes that suppliers can influence industry profitability by raising prices or reducing the quality of goods sold if industry participants are unable to recover cost increases through pricing structures. Buyers can influence the profit potential of an industry if the buyer group is able to successfully bargain for higher quality, greater levels of service, and lower prices. Substitute products influence an industry’s profit potential by placing an upper limit on prices that can be charged. New entrants to an industry influence industry profitability because they bring additional production capacity to the industry. Unless product demand is increasing, additional capacity holds down (or reduces) buyers’ costs, reducing profitability for all firms in the industry. The intensity of rivalry among competitors reflects competitor actions and responses as firms initiate moves to improve their competitive position or when they act in retaliation for competitive pressures brought about by the strategic actions of rival firms. Generally, the greater the intensity of competitive rivalry, the lower the overall profitability of an industry.

6. What is a strategic group? Of what value is knowledge of the firm’s strategic group in formulating that firm’s strategy?

A strategic group is a group of firms within an industry that generally follow the same (or a similar) strategy, competing along the same strategic dimensions (such as product quality, pricing policy, distribution channels, or level of customer service).

The strategic group concept is valuable to a firm’s strategic decision makers because a firm’s primary competitors are those within its strategic group (all group members are selling similar products to a similar group of customers), the strengths of the five competitive forces varies across strategic groups, and strategic groups that are similar (in terms of strategies followed and competitive dimensions emphasized) increase the possibility of increased competitive rivalry between the groups.

The notion of strategic groups can be useful for analyzing an industry’s competitive structure. Such analyses can be helpful in diagnosing competition, positioning, and the profitability of firms within an industry. Strategic group analysis shows which companies are competing similarly in terms of how they use similar strategic dimensions. At the same time, research has found that strategic groups differ in performance, suggesting their importance. Strategic group membership also remains relatively stable over time, making analysis easier and more useful.

Strategic groups have several implications. First, because firms within a group offer similar products to the same customers, the competitive rivalry among them can be intense. The more intense the rivalry, the greater the threat to each firm’s profitability. Second, the strengths of the five industry forces (the threats posed by new entrants, the power of suppliers, the power of buyers, product substitutes, and the intensity of rivalry among competitors) differ across strategic groups. Third, the closer the strategic groups are in terms of their strategies, the greater is the likelihood of rivalry between the groups. In the end, having a thorough understanding of primary competitors helps a firm formulate and implement an appropriate strategy.

7. What is the importance of collecting and interpreting data and information about competitors? What practices should a firm use to gather competitor intelligence and why?

Competitor analysis can help the firm understand and better anticipate competitors’ future objectives, current strategies, assumptions, and capabilities. The firm should gather intelligence about its competitors as well as about public policies in countries across the world, which can serve as an early warning of threats and opportunities emerging from the global public policy environment that may affect the achievement of the company’s strategy. Through effective competitive and public policy intelligence, the firm gains the insights needed to create a competitive advantage and to increase the quality of the strategic decisions it makes when deciding how to compete against its rivals.

Firms want to know how competitor intelligence is gathered to determine whether the practices employed are legal and, further, to assess whether these methods are ethical, given the firm’s culture and the image it desires as a corporate citizen. The line between legal and ethical practices can be difficult to ascertain, especially when it comes to electronic transmissions. Often it is difficult for a firm to know how to gather intelligence and how to prevent competitors from gathering competitive intelligence that may threaten its own competitive advantage.

Openly discussing intelligence-gathering techniques that the firm employs goes a long way toward assuring that people understand the firm’s convictions about what is ethical and acceptable for use and what is not ethical and is unacceptable for use when gathering competitor intelligence. The firm can frame these practices in terms of respect for the principles of common morality and the right of competitors not to reveal information about their products, operations, and strategic intentions.

Despite its importance, evidence suggests that a relatively small percentage of firms use formal processes to study competitors. Beyond this, some firms fail to analyze a competitor’s future objectives when trying to understand its current strategy, assumptions, and capabilities, but it is important to study the present and the future when examining competitors. Failure to do so may lead to incomplete or distorted insights about competitors.

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| **INSTRUCTOR'S NOTES FOR EXPERIENTIAL EXERCISES** |  |

**EXERCISE 1: CREATING A FIVE FORCES INDUSTRY MODEL**

The five forces model is designed to better understand the competitive forces in an industry in which a firm competes. This exercise is designed to utilize students’ analytical skills in regards to competitive forces within an industry, in this case the automotive industry.

The instructor should select a specific American automobile manufacturer and ask the class to discuss how they ranked the forces for the automobile industry, and how those forces affect the profitability of the selected manufacturer. As an example, you might select Tesla as a newer entrant to the market. You may find the following article about Tesla’s role in the market and surprising success useful as a discussion point: <http://blogs.wsj.com/speakeasy/2013/08/09/teslas-success-far-has-some-analysts-eating-crow/?KEYWORDS=tesla>

Team rankings are subjective, which allows you to encourage teams to argue their cases against each other as to why they may have chosen one ranking over the over. During the discussion, you can ask probing questions for each of the forces such as:

**1) Threat of New Entrants.** How might things like capital requirements, brand equity, government policy (things like safety, EPA and emissions regulations), access to distribution channels, etc. influence a new entrant to the market? This article on Tesla’s direct-sales approach may be useful: <http://www.huffingtonpost.com/2013/06/28/tesla-direct-sales-auto-dealers-petition_n_3516836.html>

**2) Threat of Substitutes.** How does depreciation of new vehicles play into switching costs? How does the used car market influence the threat of substitute products? Mass transportation? What other substitutes exist and how do they influence the industry?

**3) Bargaining Power of Suppliers.** Suppliers may be small are large ranging from small car components, tires, electronics to unionized assembly line workers. How does influence the automobile industry? How do automobile raw materials such as steel and aluminum influence the power of suppliers?

**4) Bargaining Power of Buyers.** To what degree can buyers push down the price of new vehicles? What does the unheard-of-pricing and discounts offered by dealers suggest?

**5) Intensity of Rivalry.** How competitive is the industry? Consider things such as fierce advertising campaigns, and product developments.

**EXERCISE 2: WHAT DOES THE FUTURE LOOK LIKE?**

The purpose of this exercise it to have the students reflect on the future and its implications for business. This can be done individually or in teams as the instructor deems appropriate. Teams are assumed since individual assignment will be time consuming.

A nice way to start this discussion is for the instructor to trace out the brief history of a product or service that students find familiar; such as cell phones or portable music players. Think back 10 years and discuss how rapidly things change. You might also discuss the competitive environment; which firms succeeded and which did not. The world for this product today is very different than just a few short years ago. Now what does the future hold?

A good way to implement this assignment is to have each team present the results of their investigation. The instructor can then question each team based on the following to inspire additional discussion:

* Of all the trends you identified, why did you choose this one? Which others did you uncover that also were interesting.
* How great a change will this be for the marketplace?
* Who do you suspect will be the winners or losers if this comes to pass?
* Do you suspect that existing firms or new firms will be the ones to implement first?
* How disruptive will this be, will entire products or services become unnecessary as a result (typewrite vs. computer).

The instructor should, as teams present, keep track of which dimensions of the general environment the teams suggest are impacted by their presentation. At the conclusion of all the presentations, summarize this list and initiate a discussion on what this means. For example if preponderance are technological and global, how will this impact US domestic located businesses? And so on.

At the conclusion of the presentations, the instructor should wrap up this exercise by discussing the implications of change. For example, the shifting list of firms that populate the S&P 500, impact of hyper competition, rate of technological change.

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| **INSTRUCTOR'S NOTES FOR VIDEO EXERCISES** |  |

Title: THE NEED TO EXAMINE THE EXTERNAL ENVIRONMENT: DISASTER IN THE GULF THREE-PLUS YEARS LATER

RT: 2:32

Topic Key: The External Environment, External Environmental Analysis, Five Forces of Competition, Strategic Groups, Competitor Analysis

With oil and tar balls washing up on the Gulf Coast, weddings on the beach became a casualty. The weddings on the beach business evaporated with cancelled orders and local flower shops were on the brink. Lee Kitchens Taylor continues to be devastated from losing 85% of her business and has given up her salary. Her business lost $90,000 dollars and had only received emergency payments of $20,000 to date. She received checks as little as $12.31 for interest payments not knowing where the principal was.

BP established a $20 billion fund to compensate victims of the oil spill but only $3.8 billion had been paid out at present. Roughly 2 out of every 5 people who filed a claim had been reimbursed, which created confusion and anxiety. Individuals claim that BP has not fulfilled their obligations.

Washington attorney Kenneth Feinberg was appointed by President Obama and BP to oversee the claims fund that pays his firm $15 million a year. Feinberg claims the program is not perfect but is working. He says that 200,000 claimants were paid in 9 months.

The beach wedding business of Jeff and Jennie Sherrill indicate they have had to live check by check and day by day. Within three days of the oil spill they had lost 14 weddings at $10,000 each, had depleted their savings, and were on the verge of closing. Months later they received a check that largely covered their 6 figure losses. However, many are still waiting and still losing and speculate they will never recoup their true losses.

*Also check out* [*http://www.ksdk.com/news/local/story.aspx?storyid=204252*](http://www.ksdk.com/news/local/story.aspx?storyid=204252)

**Suggested Discussion Questions and Answers**

1. Whatparts of theexternal environment (general, industry, and competitive) segments do you think BP considered or didn’t consider prior to their drilling off the Gulf Coast? What should the wedding business owners now consider in their external environment?
   * BP: Considered economic, political/legal, technological, and global segments in the general environment. Appears to have considered all facets of the industry environment and the competitive environment that may have been their primary motivators for the Gulf offshore drilling
   * BP: Didn’t consider the following:
     + General: demographic, sociocultural, and physical environment fully
   * Wedding business owners:
     + Need to consider demographic changes for geographic migration, economic segments particularly for rebuilding, the political/legal segment regarding the impact on their business of additional oil company regulation of oil drilling and operations, sociocultural preferences, technology requirements to avoid future business loss, the global segment regarding international company infiltration, and the physical environment to react and overcome disasters in the future
2. How should BP have handled an external environmental analysis and what environmental changes and trends (opportunities and threats) might they have discovered?
   * External environmental analysis should have included scanning, monitoring, forecasting, and assessing (See Table 2.2)
   * Opportunities: Other areas less socially affected by drilling, partnership opportunities with wedding businesses, other areas for drilling having less natural pressure, other areas will less oil drilling regulations, and more benefit in alternative energy sources
   * Threats: Possibilities of increased regulation of operations, increasing environmentally conscious society, and increasing social responsibility perceptions in society and how it impacts purchases
3. Analyze BP using the five forces of competition model, to determine the industry’s attractiveness in terms of profit potential.
   * Threat of new entrants: Not likely, given the investments and control of the controllers like BP, Exxon, and Shell—Good Profit Potential
   * Bargaining power of suppliers: BP’s disasters have opened opportunities for competition to be better suppliers—Poor Profit Potential
   * Bargaining power of buyers: BP’s disasters have created more concerns from society in their purchase behavior—Poor Profit Potential
   * Rivalry among competing firms: Revenue losses by BP give greater way to competition to compete—Poor Profit Potential
   * Threat of substitute products: BP continues to be involved in alternative energy sources and may have invested too much in the disaster than needed to be but they are still attempting to produce substitutes themselves—Good Profit Potential
4. Who might be in BP’s strategic group and why?
   * Text: Strategic group is a set of firms that emphasize similar strategic dimensions and use a similar strategy.
   * BP’s strategic group: Exxon & Shell
5. What would a competitor of BP discover about them in a competitor analysis?
   * BP, noted for its later joint ventures, is still *driven* to source, transport, refine, and distribute oil in the *future*.
   * BP *currently* is moving toward alternative energy sources to reduce emissions as required by law. Additionally, BP will abide by US regulated drilling permits and regulation safety inspections and drilling operations. Within their joint ventures, they will continue to pursue the oil to meet demand outside of heavy regulation in the US and perhaps less natural pressure for drilling.
   * BP *assumes* liability under law and operates as the law being the ethical authority.
   * BP’s *capabilities* are noted as follows:
     + *Strengths*: Ability to source, transport, refine, and distribute oil.
     + *Weaknesses:* Lack of awareness of public policies in other countries, lack of knowledge of the physical environment except with regard to earning revenue, and lack of genuine concern for demographic and sociocultural impacts from their business operations

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|  | **ADDITIONAL QUESTIONS AND EXERCISES** |  |

The following questions and exercises can be presented for in-class discussion or assigned as homework.

**Application Discussion Questions**

1. Given the importance of understanding the external environment, why do some firms fail to do so? Students can provide examples of firms that did not understand their external environment. What were the implications of the firm’s failure to understand that environment?

2. Have students select a firm and describe its external environment. What actions do you believe the firm should take, given its external environment, and why?

3. How is it possible that one firm could see a condition in the external environment as an opportunity whereas a second firm sees it as a threat?

4. Select a firm in the local community. What materials would help one understand the firm’s external environment? How could the Internet be used to complete this activity?

5. Have students select an industry that is of interest to them. What actions could firms take to erect barriers of entry to this industry?

6. What conditions would cause a firm to retaliate aggressively against a new entrant to the industry?

**Ethics Questions**

1. How can a firm use its “code of ethics” to analyze the external environment?

2. What ethical issues, if any, may be relevant to a firm’s monitoring of its external environment? Does use of the Internet to monitor the environment lead to additional ethical issues? If so, what are they?

3. Think of each segment in a firm’s general environment. What is an ethical issue associated with each segment? Are firms across the globe doing enough to deal with the issue?

4. What is the importance of using ethical practices between a firm and its suppliers?

5. In an intense rivalry, especially one that involves competition in the global marketplace, how can the firm gather competitor intelligence ethically while maintaining its competitiveness?

6. Ask the class what they believe determines whether an intelligence-gathering practice is or is not ethical? Do they see this changing as the world’s economies become more interdependent? If so, why? Do they see this changing because of the Internet? If so, how?

**Internet Exercise**

Firms rely on gathering and analyzing the general, industry, and competitor environments to assess their potential for global growth and profitability. Go to the website for the US retail chain Walmart at http://www.wal-mart.com. Walmart’s global expansion plans are extensive. List how each of the six segments of the general environment prompted Walmart to expand into the markets that it has. Target is a major US competitor of Walmart. Check out the Target website at http://www.target.com. What are the firm’s plans for global expansion? What types of opportunities and threats would prohibit Target from taking Walmart’s route? Would the students consider Target a future key global rival of Walmart?

\*e-project: What US firms offer global Web shopping in other countries’ currencies and shipping specifications? How do their non-US websites compare with their US websites?

### Strategy and Tactics of Distributive Bargaining

**Overview**

The basic elements of a distributive bargaining situation, also referred to as competitive or win-lose bargaining, will be discussed. In a distributive bargaining situation, the goals of one party are usually in fundamental and direct conflict with the goals of the other party. Resources are fixed and limited, and both parties want to maximize their share of the resources. One important strategy is to guard information carefully – one party tries to give information to the other party only when it provides a strategic advantage. Distributive bargaining is basically a competition over who is going to get the most of a limited resource.

There are two reasons that every negotiator should be familiar with distributive bargaining. First, some interdependent situations that negotiators face are distributive, and to do well in them negotiators need to understand how they work. Second, because many people use distributive bargaining strategies and tactics almost exclusively, all negotiators will find it important to know how to counter their effects.

Some of the tactics discussed in the chapter will also generate ethical concerns. Some tactics are ethically accepted behavior whereas other tactics are generally considered unacceptable.

1. **The Distributive Bargaining Situation**
   1. Distributive bargaining strategies and tactics are useful whena negotiator wants to maximize the value obtained in a single deal, when the relationshipwith the other party is not important, and when they are at the claiming value stage ofnegotiations.
      1. The *target point* is a negotiator’s optimal goal, or the point at which she/he would like to conclude negotiations. The optimal goal is also referred to as resistance.
      2. The *resistance point* is a negotiator’s bottom line – the point beyond which a person will not go. This is not known to the other party and should be kept secret. The resistance point is a high price for the buyer and a low price for the seller.
      3. The *asking price* is the initial price set by the seller, or the first number quoted by the seller.
      4. Both parties to a negotiation should establish their starting, target, and resistance points before beginning a negotiation.
      5. The spreads between the resistance points, called the bargaining range, settlement range, or zone of potential agreement are very important. It is the area where actual bargaining takes place. When the buyer’s resistance point is above the seller’s he is minimally willing to pay more than she is minimally willing to sell for, there is a positive bargaining range.
   2. The role of alternatives to a negotiated agreement.
      1. Alternatives are important because they give negotiators the power to walk away from any negotiation when the emerging deal is not very good.
         1. The role of alternatives are two fold:
            1. Reach a deal with the other party.
            2. No settlement at all.
   3. Settlement point.

1. For agreement to occur, both parties must believe that the settlement is the best that they can get (within a positive bargaining range).

* 1. Bargaining mix.
     1. The agreement necessary on several issues: the price, the closing date of the sale, renovations to the condo, and the price of items that could remain in the condo (such as drapes and appliances).
  2. Discovering the other party’s resistance point.
     1. Learning about the other party’s resistance point, target, motives, feelings of confidence, and so on, the more likely you will be able to have a favorable settlement. You do not want the other party to know your resistance point. Because each party wants to know the other’s resistance point, communication can become complex.
  3. Influencing the other party’s resistance point.
     1. The following factors are important in attempting to influencing the other party’s resistance point:
        1. The value the other attaches to a particular outcome;
        2. The costs the other attaches to delay or difficulty in negotiations;
        3. The cost the other attaches to having the negotiations aborted.
     2. Understanding your own situation, and the value of your particular outcome, will help you to understand the other person’s. Four major positions show how this affects the distributive bargaining process:
        1. The higher the other party’s estimate of *your* cost of delay or impasse, the stronger the other party’s resistance point will be;
        2. The higher the other party’s estimate of his or her *own* cost of delay or impasse, the weaker the other party’s resistance point will be;
        3. The less the other party values an issue the lower the resistance point will be;
        4. The more the other party believes that you value an issue the lower their resistance point will be.

1. **Tactical Tasks**
   1. There are four important tactical tasks for a negotiator in a distributive situation to consider:
      1. Assess the other party’s target, resistance point, and cost of terminating negotiations
         1. Indirect assessment means determining what information an individual likely used to set target and resistance point sand how he or she interpreted this information.
            1. Indirect indicators can be a source to assess the other party’s resistance point, and can include observations, consulting documentation and publications, speaking to experts.
         2. Direct assessment, in bargaining, is where the other party does not usually reveal accurate and precise information about his or her outcome values, resistance points, and expectations.
      2. Manage the other party’s impression of the negotiator’s target, resistance point, and cost of terminating negotiation, while also guiding him or her to form a preferred impression of them.
         1. Screening activities – say as little as possible. Instead, use words to ask the other negotiator questions.
         2. Direct action to alter impressions ̶ through selective presentation:
            1. Negotiators reveal only the facts necessary to support their case;
            2. Lead the other party to form the desired impression of their resistance point or to open up new possibilities for agreement that are more favorable to the presenter than those that currently exist;
            3. Emotional reaction to facts, proposals, and possible outcomes;

There are several hazards in taking direct action: perception of dishonesty, which can lead to the other party conceding on minor points to defeat the maneuverer at his or her own game.

* + 1. Modify the other party’s perception of his or her own target, resistance point, and cost of terminating negotiation.
    2. Manipulate the actual costs of delaying or terminating negotiations through:
       1. *Planning disruptive action*: Increasing the costs of not reaching a negotiated agreement;
       2. *Forming an alliance with outsiders* who can somehow influence the outcome of the negotiation;
       3. *Manipulating the scheduling of negotiations* can put the other party at a considerable disadvantage by enhancing your position and protect you from the other party’s actions.

1. **Positions Taken During Negotiation**
   1. Opening offers.
      1. Making the first offer is advantageous to the negotiator making the offer because he or she can anchor a negotiation. Exaggerating an opening offer is advantageous because:
         1. It gives the negotiator room for movement thereby giving him or her time to learn about the other party’s priorities;
         2. May create an impression in the other party’s mind that:
            1. There is a long way to go before a reasonable settlement will be achieved;
            2. A greater number of concessions will have to be made to find a common zone of potential agreement (ZOPA);
            3. The other may have incorrectly estimated his or her own resistance point.
      2. Two disadvantages to exaggerating an offer include:
         1. Potential rejection by the other party;
         2. The perception of a “tough” attitude that can harm a long-term relationship.
   2. An *opening stance* is the attitude the negotiator will adopt during a negotiation (competitive, belligerent, moderate, etc.). To communicate effectively, a negotiator should try and send a consistent message through both the opening and stance.
   3. Usually met with a counteroffer, *initial concessions* define the initial bargaining range; they communicate to the other party how you intend to negotiate.
   4. *Role of concessions* – Negotiations would not exist without them. There is ample data to show that parties feel better about a settlement when the negotiation involved a progression of concessions than when it didn’t.
   5. The *pattern of concessions* made during a negotiation contains valuable information, though not always easy to interpret.
   6. *Final offers*  ̶ a negotiator wants to convey the message that there is no further room for movement. One way to accomplish this is to make the last concession more substantial.
2. **Commitment**

Commitment is the taking of a bargaining position with some explicit or implicit pledge regarding the future course of action.

* 1. Tactical considerations in using commitments.

1. Contingency plans should be made.

2. Commitments exchange flexibility for certainty of action, but they create difficulties if one wants to move to a new position.

* 1. Establishing a commitment.
     1. A commitment statement has three properties:
        1. A high degree of finality;
        2. A high degree of specificity;
        3. A clear statement of consequences.
     2. There are several ways to create commitment:
        1. Public pronouncement;
        2. Linking with an outside base;
        3. Increase the prominence of demands;
        4. Reinforce the threat or promise.
     3. Several things can be done to reinforce the threat in a commitment:
        1. Review similar circumstances and their consequences;
        2. Make obvious preparations to carry out the threat;
        3. Create and carry out minor threats in advance, leading the other party to believe that major threats will be fulfilled.
     4. Preventing the other party from committing prematurely.
        1. Approaches to preventing commitment:
           1. Denying negotiator the necessary time;
           2. Ignore or downplay a threat by not acknowledging the other’s commitment.
  2. Finding ways to abandon a committed position.
     1. There are four avenues to use in abandoning a commitment:
        1. Plan a way out;
        2. Let it die silently;
        3. Restate the commitment;
        4. Minimize the damage.

1. **Closing the Deal**
   1. *Provide alternatives* – rather than making a single final offer, provide two or three alternative packages for the other party that are roughly equal in value.
   2. *Assume the close* – having a general discussion about the needs and positions of the buyer, then act as if the decision to purchase something has already been made.
   3. *Split the difference* – the most popular tactic used; used when an agreement is close, suggesting that the parties split the difference.
   4. *Exploding offers* – An offer that contains an extremely tight deadline in order to pressure the other party to agree quickly.
      1. The purpose of an exploding offer is to convince the other party to accept the settlement and to stop considering outcomes.
   5. *Sweeteners* – negotiators need to include the sweetener in their negotiation plans or they may concede too much during the close.
2. **Hardball Tactics**
   1. Dealing with typical hardball tactics – there are several choices about how to respond.
      1. Discuss them.
      2. Ignore them.
      3. Respond in kind.
      4. Co-opt the other party.
   2. Typical hardball tactics.
      1. Good cop/bad cop.
         1. Weaknesses:
            1. Relatively transparent;
            2. Difficult to enact – requires a lot of energy toward making the tactic work.
      2. Lowball/highball.
         1. Risk in using this tactic:
            1. The other party will think it is a waste of time to negotiate and stop the process.
         2. Strategies for using this tactic:
            1. Insisting that the other party start with a reasonable opening offer and refusing to negotiate further until he or she does;
            2. Stating your understanding of the general market value of the item being discussed, supporting it with facts and figures, thus showing the other party that you won’t be tricked;
            3. Threatening to leave the negotiation, showing dissatisfaction in the other party in using this tactic;
            4. Responding with an extreme counter offer.
      3. Bogey.
         1. Negotiators use this tactic to pretend that an issue is of little or no importance to them, when it actually is quite important.
      4. The nibble.
         1. Weaknesses in using the nibble:
            1. The party using the nibble did not bargain in good faith.
         2. Combating the nibble tactic:
            1. Respond with each nibble with the question “What else do you want?”;
            2. Have your own nibbles prepared for exchange.
      5. Chicken.
         1. Combining a large bluff with a threatened action to force the other party to “chicken out” and give them what they want.
         2. Weakness of chicken tactic:
            1. Turns the negotiation into a serious game in which one or both parties find it difficult to distinguish reality from postured negotiation positions;
            2. Difficult to defend against.
      6. Intimidation
         1. An attempt to force the other party to agree by means of an emotional ploy. Negotiators intimidate by:
            1. Using anger;
            2. Increasing the appearance of legitimacy;
            3. Guilt.
      7. Aggressive behavior.
         1. Aggressive tactics include:
            1. Relentless push for further concessions;
            2. Asking for the best offer early in negotiations;
            3. Asking the other party to explain and justify his/her proposals.
      8. Snow job.
         1. Snow jobs occur when negotiators overwhelm the other party with so much information that he/she has trouble determining which facts are real or important, and which are distractions.
3. **Distributive Bargaining Skills Applicable to Integrative Negotiations**
   1. Many distributing bargaining skills are also applicable to integrative negotiations when negotiators need to claim value, or decide how to divide their joint gain. Some applicable skills include:
      1. Setting clear target and resistance points;
      2. Understanding and working to improve their BATNA;
      3. Starting with a good opening offer;
      4. Making appropriate concessions;
      5. Managing the commitment process.

# Summary

This chapter examined the basic structure of competitive or distributive bargaining situations and some of the strategies and tactics used in distributive bargaining. Distributive bargaining begins with setting your own opening, target, and resistance points. All points are important, but the resistance points are the most critical. The spread between the parties’ resistance points defines the bargaining range.

It is rare that a negotiation includes only one item; more typically, there is a set of items, referred to as a bargaining mix. Each item in a bargaining mix can have opening, target, and resistance points. The bargaining mix may provide opportunities for bundling issues together, trading off across issues, or displaying mutually concessionary behavior.

Examining the structure of distributive bargaining reveals many options for a negotiator to achieve a successful resolution; most of which fall within two broad efforts: to influence the other party’s belief about what is possible and to learn as much as possible about the other party’s position, particularly about the resistance points. The negotiator’s basic goal is to reach a final settlement as close to the other party’s resistance point as possible. Negotiators work to gather information about the opposition and its positions; to convince members of the other party to change their minds about their ability to achieve their own goals; and to promote their own objectives as desirable, necessary, or even inevitable.

Distributive bargaining is basically a conflict situation, wherein parties seek their own advantage, in part through concealing information, attempting to mislead, or using manipulative actions. All these tactics can easily escalate interaction from calm discussion to bitter hostility. Yet negotiation is the attempt to resolve a conflict without force, without fighting. Further, to be successful, both parties to the negotiation must feel at the end that the outcome was the best that they could achieve and that it is worth accepting and supporting. Effective distributive bargaining is a process that requires careful planning, strong execution, and constant monitoring of the other party’s reactions.

# History of Management

**2.1 Explain the origins of management.**

Management as a field of study is just 125 years old, but management ideas and practices have actually been used since 5000 BCE. From ancient Sumeria to 16th-century Europe, there are historical antecedents for each of the functions of management discussed in this textbook: planning, organizing, leading, and controlling. However, there was no compelling need for managers until systematic changes in the nature of work and organizations occurred during the last two centuries. As work shifted from families to factories; from skilled laborers to specialized, unskilled laborers; from small, self-organized groups to large factories employing thousands under one roof; and from unique, small batches of production to standardized mass production; managers were needed to impose order and structure, to motivate and direct large groups of workers, and to plan and make decisions that optimized overall performance by effectively coordinating the different parts of an organizational system.

**2.2 Explain the history of scientific management.**

Scientific management involves studying and testing different work methods to identify the best, most efficient way to complete a job. According to Frederick W. Taylor, the father of scientific management, managers should follow four scientific management principles. First, study each element of work to determine the one best way to do it. Second, scientifically select, train, teach, and develop workers to reach their full potential. Third, cooperate with employees to ensure that the scientific principles are implemented. Fourth, divide the work and the responsibility equally between management and workers. Above all, Taylor felt these principles could be used to align managers and employees by determining a fair day’s work, what an average worker could produce at a reasonable pace, and a fair day’s pay (what management should pay workers for that effort). Taylor felt that incentives were one of the best ways to align management and employees.

Frank and Lillian Gilbreth are best known for their use of motion studies to simplify work. Whereas Taylor used time study to determine a fair day’s work based on how long it took a “first-class man” to complete each part of his job, Frank Gilbreth used film cameras and microchronometers to conduct motion study to improve efficiency by eliminating unnecessary or repetitive motions. Henry Gantt is best known for the Gantt chart, which graphically indicates when a series of tasks must be completed to perform a job or project, but he also developed ideas regarding worker training (all workers should be trained and their managers should be rewarded for training them).

**2.3 Discuss the history of bureaucratic and administrative management.**

Today, we associate bureaucracy with inefficiency and red tape. Yet, German sociologist Max Weber thought that bureaucracy—that is, running organizations on the basis of knowledge, fairness, and logical rules and procedures—would accomplish organizational goals much more efficiently than monarchies and patriarchies, where decisions were based on personal or family connections, personal gain, and arbitrary decision making. Bureaucracies are characterized by seven elements: qualification-based hiring; merit-based promotion; chain of command; division of labor; impartial application of rules and procedures; recording rules, procedures, and decisions in writing; and separating managers from owners. Nonetheless, bureaucracies are often inefficient and can be highly resistant to change.

The Frenchman Henri Fayol, whose ideas were shaped by his more than 20 years of experience as a CEO, is best known for developing five management functions (planning, organizing, coordinating, commanding, and controlling) and fourteen principles of management (division of work, authority and responsibility, discipline, unity of command, unity of direction, subordination of individual interests to the general interest, remuneration, centralization, scalar chain, order, equity, stability of tenure of personnel, initiative, and *esprit de corps*).

**2.4 Explain the history of human relations management.**

Unlike most people who view conflict as bad, Mary Parker Follett believed that it should be embraced rather than avoided. Of the three ways of dealing with conflict––domination, compromise, and integration––she argued that the latter was the best because it focuses on developing creative methods for meeting conflicting parties’ needs.

Elton Mayo is best known for his role in the Hawthorne Studies at the Western Electric Company. In the first stage of the Hawthorne Studies, production went up because the increased attention paid to the workers in the study and their development into a cohesive work group led to significantly higher levels of job satisfaction and productivity. In the second stage, productivity dropped because the workers had already developed strong negative norms. The Hawthorne Studies demonstrated that workers’ feelings and attitudes affected their work, that financial incentives weren’t necessarily the most important motivator for workers, and that group norms and behavior play a critical role in behavior at work.

Chester Barnard, president of New Jersey Bell Telephone, emphasized the critical importance of willing cooperation in organizations. In general, Barnard argued that people will be indifferent to managerial directives or orders if they (1) are understood, (2) are consistent with the purpose of the organization, (3) are compatible with the people’s personal interests, and (4) can actually be carried out by those people. Acceptance of managerial authority (i.e., cooperation) is not automatic, however.

**2.5 Discuss the history of operations, information, systems, and contingency management.**

Operations management uses a quantitative or mathematical approach to find ways to increase productivity, improve quality, and manage or reduce costly inventories. The manufacture of standardized, interchangeable parts, the graphical and computerized design of parts, and the accidental discovery of just-in-time inventory systems were some of the most important historical events in operations management.

Throughout history, organizations have pushed for and quickly adopted new information technologies that reduce the cost or increase the speed with which they can acquire, store, retrieve, or communicate information. Historically, some of the most important technologies that have revolutionized information management were the creation of paper and the printing press in the 14th and 15th centuries, the manual typewriter in 1850, the cash register in 1879, the telephone in the 1880s, the personal computer in the 1980s, and the Internet in the 1990s.

A system is a set of interrelated elements or parts (subsystems) that function as a whole. Organizational systems obtain inputs from both general and specific environments. Managers and workers then use their management knowledge and manufacturing techniques to transform those inputs into outputs, which, in turn, provide feedback to the organization. Organizational systems must also address the issues of synergy and open *versus* closed systems.

Finally, the contingency approach to management clearly states that there are no universal management theories. The most effective management theory or idea depends on the kinds of problems or situations that managers or organizations are facing at a particular time. This means that management is much harder than it looks.

## Terms

**Bureaucracy**

**Closed systems**

**Contingency approach**

**Gantt Chart**

**Integrative conflict resolution**

**Motion study**

**Open systems**

**Organization**

**Rate buster**

**Scientific management**

**Soldiering**

**Subsystems**

**Synergy**

**System**

**Time study**

### What Would You Do? Case Assignment

#### ISG STEELTON

**International Steel Group, Steelton, Pennsylvania.**

As the day-shift supervisor at the ISG Steelton steel plant, you summon the six college students who are working for you this summer, doing whatever you need done (sweeping up, sandblasting the inside of boilers that are down for maintenance, running errands, and so forth). You walk them across the plant to a field where the company stores scrap metal. The area, about the size of a football field, is stacked with organized piles of metal. You explain that everything they see has just been sold. Metal prices, which have been depressed, have finally risen enough that the company can earn a small profit by selling its scrap.

You point out that railroad tracks divide the field into parallel sectors, like the lines on a football field, so that each stack of metal is no more than 15 feet from a track. Each stack contains 390 pieces of metal. Each piece weighs 92 pounds and is about a yard long and just over 4 inches high and 4 inches wide. You tell the students that, working as a team, they are to pick up each piece, walk up a ramp to a railroad car that will be positioned next to each stack, and then neatly position and stack the metal for shipment. That’s right, you repeat, *92* pounds, *walk* up the ramp, and *carry* the metal onto the rail car. Anticipating their questions, you explain that a forklift could be used only if the metal were stored on wooden pallets (it isn’t); if the pallets could withstand the weight of the metal (they would be crushed); and if you, as their supervisor, had forklifts and people trained to run them (you don’t). In other words, the only way to get the metal into the rail cars is for the students to carry it.

Based on an old report from the last time the company sold some of the metal, you know that workers typically loaded about 30 pieces of metal parts per hour over an 8-hour shift. At that pace, though, it will take your six students *6 weeks* to load all of the metal. But the purchasing manager who sold it says it must be shipped in *2* weeks. Without more workers (there’s a hiring freeze) and without forklifts, all of the metal has to be loaded by hand by these six workers in 2 weeks. But how do you do that? What would motivate the students to work much, much harder than they have all summer? They’ve gotten used to a leisurely pace and easy job assignments. Motivation might help, but motivation will only get so much done. After all, short of illegal steroids, nothing is going to work once muscle fatigue kicks in from carrying those 92-pound pieces of metal up a ramp all day long. What can you change about the way the work is done to deal with the unavoidable physical fatigue?

### What Really Happened? Solution

In the case, you learned that six college students had summer jobs working for a supervisor at International Steel Group in Steelton, Pennsylvania. Their task, over the next two weeks, was to load thousands of 92-pound pieces of metal onto nearby railroad cars for shipping. Unfortunately, since the metal pieces were stacked individually and not on pallets, it wouldn’t be possible to use a forklift to load them. Likewise, because of a hiring freeze, the supervisor didn’t have the option of hiring more workers. In other words, the only way to get the metal parts into the rail cars was for the college students to load them by hand. Previous experience with this task indicated that workers typically carried 30 to 31 metal parts per hour up the ramp into a rail car. At that pace, it would take the six college students six weeks to load all of the metal. Unfortunately, however, the purchasing manager who sold the metal had already agreed to have it all loaded and shipped within two weeks. Your job as a supervisor was to figure out how to solve this dilemma.

That general scenario is actually based on one of the most famous cases in the history of management, the pig iron experiments, which were conducted by Frederick W. Taylor, the father of scientific management, at Bethlehem Steel in Bethlehem, Pennsylvania, in 1899. Bethlehem Steel had 10,000 long tons (a long ton is 2,240 pounds) of pig iron on hand. Each pig was 32 inches long, approximately 4 inches high and 4 inches wide, and weighed, on average, about 92 pounds. After the price of a long ton of pig iron rose from $11 to $13.50 per ton, the company sold all 10,000 long tons of pig iron and used work crews to load it onto rail cars for shipping. And, like our college students in the opening case, the laborers at Bethlehem Steel had the job of carrying 92-pound pieces of pig iron up a steep plank and loading them onto a railroad car. Over the course of a 10-hour day, the average laborer could load about 12.5 tons, or 304 to 305 pieces, of pig iron per day; in other words, 30 to 31 pieces per hour. Based on a study analyzing the workers and how long it took them to complete each step involved in loading pig iron, Taylor and his associates, James Gillespie and Hartley Wolle, determined that the average laborer should be able to load 47.5 tons, or 1,156 pieces, of pig iron per day, or 115 to 116 pieces per hour over a 10-hour day. Nearly four times as much! Of course, the question was how to do it. Taylor wrote: “It was our duty to see that the… pig iron was loaded on to the cars at the rate of 47 tons per man per day, in place of 12.5 tons, at which rate the work was then being done. And it was further our duty to see that this work was done without bringing on a strike among the men, without any quarrel with the men, and to see that the men were happier and better contented when loading at the new rate of 47 tons than they were when loading at the old rate of 12.5 tons.”

Let’s find out what really happened and see what steps Frederick W. Taylor and his associates took to try to achieve this goal.

*So, without more workers (there’s a hiring freeze) and without forklifts, it all has to be loaded by hand by these six workers in two weeks. But how do you do that? What would motivate them to work much, much harder than they have been all summer? After all, they’ve gotten used to the leisurely pace and job assignments.*

One of Taylor’s strongest beliefs was that it was management’s responsibility to pay workers fairly for their work, or as Taylor would put it “a fair day’s pay for a fair day’s work.” In essence, in an age of labor unrest when managers and workers distrusted, if not hated, each other, Taylor was trying to align management and employees so that each could see that what was good for employees was also good for management. Once this was done, he believed that workers and managers could avoid the conflicts that he had experienced at Midvale Steel. And one of the best ways, according to Taylor, to align management and employees was to use incentives to motivate workers. Taylor wrote that “…in order to have any hope of obtaining the initiative of his workmen the manager must give some special incentive to his men beyond that which is given to the average of the trade. This incentive can be given in several different ways, as, for example, the hope of rapid promotion or advancement; higher wages, either in the form of generous piecework prices or of a premium or bonus of some kind for good and rapid work; shorter hours of labor; better surroundings and working conditions than are ordinarily given, etc., and, above all, this special incentive should be accompanied by that personal consideration for, and friendly contact with, his workmen which comes only from a genuine and kindly interest in the welfare of those under him. It is only by giving a special inducement or ‘incentive’ of this kind that the employer can hope even approximately to get the ‘initiative’ of his workmen.”

So, what kind of incentives did Taylor provide the laborers who were loading pig iron onto the rail cars? Taylor increased worker’s pay by 61 percent, from $1.15 a day to approximately $1.85 a day, contingent on loading 47.5 tons of pig iron. While that may not sound like much today, imagine if you were offered a 61% increase in pay. For example, since the average business college graduate earns a starting salary of about $40,000 a year, imagine being offered a $24,000 increase in pay. Would that increase motivate you? How much harder would you be willing to work for a 61% increase in pay? Here’s what Taylor wrote regarding the motivating power of money for Henry Knolle (called “Schmidt” in Taylor’s book), who was one of the pig iron handlers: “We found that upon wages of $1.15 a day he had succeeded in buying a small plot of ground, and that he was engaged in putting up the walls of a little house for himself in the morning before starting to work and at night after leaving. He also had the reputation of being exceedingly ‘close,’ that is, of placing a very high value on a dollar. As one man whom we talked to about him said, ‘A penny looks about the size of a cart-wheel to him.’” When asked whether he wanted to earn $1.85 per day, what Taylor called a “high-priced man,” Knolle, who had immigrated to the United States, responded, “Did I vant $1.85 a day? Vas dot a high-priced man? Vell, yes, I vas a high-priced man.” Taylor wrote: “And throughout this time he [Knolle] averaged a little more than $1.85 per day, whereas before he had never received over $1.15 per day, which was the ruling rate of wages at that time in Bethlehem. That is, he received 60% higher wages than were paid to other men who were not working on task work.” In fact, the pay increase could be even larger or smaller depending on how much each worker loaded each day. For example, worker Simon Conrad averaged 55.1 tons per day and thus received an average of $2.07 per day. Likewise, worker Joseph Auer averaged 49.9 tons per day and received an average of $1.87 per day. Were all workers able to make more money under this incentive system? No, and Taylor indicated that only about one in eight workers was capable of that level of performance at this task. For some, the work was too physically taxing [more on that below], and they were allowed to return to the guaranteed daily wage of $1.15 per day. But, when Taylor’s incentive system was used with workers who were physically capable of performing the job (and Taylor’s third principle of scientific management indicates that managers should select workers on the basis of their aptitude to do a job well) the amount of pig iron loaded per day typically increased by a factor of three or four.

In the long run, was Taylor right about the motivating power of money? Yes and no. Yes, in that numerous studies over the last 100+ years show that when financial rewards are clearly tied to performance, they significantly increase individual performance. Do financial rewards work all of the time? No. But, as you’ll learn in Chapter 13 on motivation, linking financial rewards to individual performance increases performance 68% of the time in general and 84% of the time in manufacturing settings, such as at Bethlehem Steel. So, how was Taylor wrong about the motivating power of money? Well, to the extent to which the results of the pig iron experiments were considered representative, it should be noted that few others have been able to achieve the quadrupling of performance that was associated with financial incentives in Taylor’s pig iron experiments. On average, using individually based financial incentives increases performance “just” 23% to 30%. However, 23% to 30% is still a large increase in performance, and you’ll see few companies ignore management ideas that can bring about such large improvements.

*And while motivation might help, motivation will only get so much done. After all, short of illegal steroids, nothing is going to work once muscle fatigue kicks in from carrying those 92-pound parts up a ramp all day long. So, what can you change about the way the work is done to deal with the physical fatigue that can’t be avoided from this kind of work?*

Another of Taylor’s controversial proposals was to give rest breaks to workers doing physical labor. We take morning, lunch, and afternoon breaks for granted, but in Taylor’s day, factory workers were expected to work without stopping. If they were being paid for 10 hours of work, then they should be working for those 10 hours. When Taylor said that breaks would increase worker productivity, no one believed him. Given the prevalent beliefs of the time, people just didn’t comprehend how time spent not working, such as rest breaks, could actually lead to more work getting done. In short, people believed that if you worked fewer minutes, you’d get less done, not more.

However, Taylor understood that especially with physical labor, rest was necessary. (Today we know that rest breaks are needed for all kinds of work.) Taylor wrote: “When a laborer is carrying a piece of pig iron weighing 92 pounds in his hands, it tires him about as much to stand still under the load as it does to walk with it, since his arm muscles are under the same severe tension whether he is moving or not.” He further said: “It will also be clear that in all work of this kind it is necessary for the arms of the workman to be completely free from load (that is, for the workman to rest) at frequent intervals. Throughout the time that the man is under a heavy load the tissues of his arm muscles are in process of degeneration, and frequent periods of rest are required in order that the blood may have a chance to restore these tissues to their normal condition.” Taylor referred to the fatigue that physical work generated as the law of heavy laboring. He explained: “Practically all such work consists of a heavy pull or a push on the man's arms, that is, the man's strength is exerted by either lifting or pushing something which he grasps in his hands. And the law is that for each given pull or push on the man's arms it is possible for the workman to be under load for only a definite percentage of the day. For example, when pig iron is being handled (each pig weighing 92 pounds), a first-class workman can only be under load 43% of the day. He must be entirely free from load during 57%of the day. And as the load becomes lighter, the percentage of the day under which the man can remain under load increases. Thus, if the workman is handling a half-pig, weighing 46 pounds, he can then be under load 58% of the day and only has to rest during 42%. As the weight grows lighter the man can remain under the load during a larger and larger percentage of the day, until finally a load is reached which he can carry in his hands all day long without being tired out.”

Here’s Taylor’s explanation of how rest breaks were actually used with the pig iron loaders: “Schmidt [the laborer, Henry Knolle] started to work, and all day long, and at regular intervals, was told by the man [one of Taylor’s associates] who stood over him with a watch, ‘Now pick up a pig and walk. Now sit down and rest. Now walk—now rest,’ etc. He worked when he was told to work, and rested when he was told to rest, and at half-past five in the afternoon had his 47.5 tons loaded on the car.” Taylor further explained: “Practically the men were made to take a rest, generally by sitting down, after loading ten to twenty pigs. This rest was in addition to the time which it took them to walk back from the car to the pile. It is likely that many of those who are skeptical about the possibility of loading this amount of pig iron do not realize that while these men were walking back they were entirely free from load, and that therefore their muscles had, during that time, the opportunity for recuperation.”

Some academicians are critical of Taylor with respect to the short-term effects of rest breaks, pointing out that the pig iron laborers could only work at most for two or three consecutive days at these high levels (i.e., four times the normal workload) before having to take two or three days off to recover from the cumulative physical fatigue of this difficult job. However, under Taylor’s plan the workers weren’t penalized or exploited because of this. During the two or three days “off” from the high load/high payment plan, they simply moved a smaller number of pig irons under the regular pay plan under which they were guaranteed $1.15 per day. It can be assumed that during these “off” days, the workers recovered from their heavier work days by only moving the typical 12.5 tons of pig iron per day. Furthermore, even though the physical demands of the work made it likely that most of the workers spent no more than half of their time on the high load/high payment plan, they were able to move so much more pig iron tonnage under that incentive plan (compared to the standard $1.15 plan) that the overall average cost of handling a ton of pig iron dropped by slightly more than half, from $0.072 to $0.033 per ton. However, workers benefited as well, earning somewhere between 30% and 60% more money, depending on the percentage of days they worked under the high load/high payment plan and how much pig iron they were able to load on those days.

In the end, what can we take away from Taylor’s pig iron experiments? This excerpt from a 1915 speech he made to the Cleveland Advertising Club can help us put them into the proper perspective:

*Most people think scientific management is chiefly handling pig-iron. I do not know why (laughter). I do not know how they have gotten that impression, but a large part of the community has that impression. The reason I chose pig-iron for the first illustration [of scientific management] is that if you can prove to any one that the strength, the effort of those four principles when applied to such rudimentary work as that, the presumption is that it can be applied to something better. The only way to prove it is to start at the bottom and show these four principles all along the line.*

Basically, Taylor’s pig iron experiments were intended as a demonstration of the power of his four principles of scientific management, shown below.

**First**: Develop a science for each element of a man’s work which replaces the old rule-of-thumb method.

**Second**: Scientifically select and then train, teach, and develop the workman, whereas in the past he chose his own work and trained himself as best he could.

**Third**: Heartily cooperate with the men so as to insure all of the work being done in accordance with the principles of the science which has been developed.

**Fourth**: There is an almost equal division of the work and the responsibility between the management and the workmen. The management takes over all the work for which they are better fitted than the workmen, while in the past almost all of the work and the greater part of the responsibility were thrown upon the men.

In short, if those principles could work extremely well in basic jobs, such as heavy manual labor, then what results might they produce with even more complex tasks and jobs? Taylor summarizes what we should learn as follows.

It is no single element, but rather this whole combination, that constitutes scientific management, which may be summarized as:

* Science, not rule of thumb.
* Harmony, not discord.
* Cooperation, not individualism.
* Maximum output, in place of restricted output.
* The development of each man to his greatest efficiency and prosperity.

### Management Decision

### Purpose

The purpose of this case is for student groups to analyze a conflict between management and employees, and to find a solution that will satisfy both parties.

### Setting It Up

You can introduce this case by, first, asking students “Is there a way for a company to cut jobs and costs without angering employees?” Then, ask students “What is the best way that employees can convince a company not to cut jobs?”

#### TOUGH LOVE?

The first job you had, on an auto-parts assembly line, was an absolute nightmare, mostly because of your boss. If you were literally one minute late for your shift, he docked you a half-hour of pay. If you weren’t ten minutes early for every staff meeting, he would yell at you, in front of everyone else, for being late. If you took a sick day, he would call you three or four times a day to make sure you were bedridden at home. He once even called your doctor!

So when you became a manager at a software firm, you decided that you would never be that kind of boss. Even though there was much pressure to meet deadlines and quality standards, you always tried to make your place a relaxed atmosphere. You didn’t set a dress code, you let your staff set their own hours, and you never even thought of yelling at them or calling them out in public.

Lately, though, you wonder whether maybe you’ve been a little too lax. Several employees have been showing up really late for work, or taking days and even weeks off with no advance notice. What’s worse, they are giving really odd excuses for not showing up for work. One of your quality control engineers, who repeatedly showed up for work late, blamed his cat for hiding his car keys. One of his software engineers said that she couldn’t show up for work for three days because she dyed her hair blond, and it looked “tragic.” Even your Human Resources (HR) director got in on the act, saying that she had to have two weeks off because she broke up with her boyfriend and had to take a trip to Hawaii with another guy to deal with the pain.

Needless to say, you’re getting frustrated, not only because your employees’ absences are killing your productivity but also because you feel like they are treating you like a moron with their excuses. You want to find a way to bring some discipline back into your company, but you don’t want to end up being authoritarian like your first boss.

**Questions**

1. How would you resolve the situation described in this scenario?  
     
   Student responses will vary.

What is an effective way for a manager to balance the need for supporting employee morale with the need for establishing discipline and authority?   
  
The text discusses a number of managerial theories that have relevance for balancing managerial authority with employee morale. One concept to consider is bureaucratic management, which is defined as “the exercise of control on the basis of knowledge.” The aim of bureaucracy is not to protect authority but to achieve goals in the most efficient way possible. This like hiring, promotion, and punishment is based completely on experience and achievement. In bureaucratic management, a clear chain of command is established in an organization, so that employees know who they need to obey. However, they are also given access to a grievance process so that they know how and why rules are applied. Bureaucratic management also emphasizes the importance of applying rules and policies to everyone equally, and to record all decisions in writing. In short, bureaucratic management is a way to apply rules in the workplace, and communicate that it’s done so on the basis of what employees do, rather than personal feelings of manager.   
  
Mary Parker Follett’s work on constructive conflict might also provide an answer for how a manager can approach employee discipline. Follett wrote that in a conflict, it may be easy for a manager to exercise domination by telling the employee what to do, or for both parties to compromise by giving up something. She recommends, however, that the best way to resolve a conflict is through integrative conflict resolution, in which both parties meet, indicate their preferences, and then work together to find an alternative that satisfies both. So in this case, for example, instead of heavy discipline or penalties, a manager might choose to meet with a recurrently late employee, communicate the importance of showing up on time, let the employee share honestly why he has trouble showing up on time, and then work for a mutually beneficial solution.   
  
Students’ responses should also refer to the work of Chester Barnard on the acceptance of authority. Barnard maintained that it is more effective to induce workers’ willing cooperation through incentives, clearly formulated organizational objectives, and effective communication. Barnard argued that managers can gain others’ cooperation by completing three executive functions: securing essential services from individuals, formulating an organization’s purpose and objectives, and providing a system of communication. In other words, managers must find ways to encourage workers to cooperate with each other and management willingly. This can occur through material incentives like rewards or nonmaterial incentives like recognition. Managers should also make clear what needs to be accomplished. Simply put, they must communicate with employees what the organization’s goals and purposes are, and why it is important to those goals that they show up on time. Barnard writes that the acceptance of authority also depends on how workers perceive authority. Asking people to do things that run contrary to organizational purposes or their own benefits won’t work. Neither will violating an employee’s zone of indifference. So, in this case, a manager must make sure that the order to show up to work on time is all about organizational goals and productivity, rather than asking people what they do with their personal time.

### Management Team Decision

### Purpose

Every manager must make decisions on a daily basis. Sometimes it’s large-scale decisions like creating a new strategic plan to increase sales. At other times, it’s smaller-scale decisions like smoking policies, or as in the case here, an office dress code. In this case, students are asked to decide whether a company should allow a casual dress code or require its employees to dress up. While it may not be a monumental decision on the scale of a new marketing strategy, it will have considerable effect on the morale and effectiveness of the employees.

### Setting It Up

You can introduce this case to students by asking them to imagine a very formal workplace, one in which employees are given a dress code. What would be the pros and cons of such a workplace? Next, ask students to imagine a very informal workplace, with no dress code, or titles, or hierarchy. What would be the pros and cons of such a workplace?

#### RESOLVING CONFLICTS

As a manager with lots of experience in negotiations, you’ve experienced a lot of different conflicts. There was that one case where a worker argued that he should be allowed to smoke his (legally prescribed) marijuana at his desk. Another time, someone asked you to mediate between two executives who were having a strategic disagreement—one thought that the company should invest in tulip futures, while the other thought that pork bellies were the future. But even with all of this experience, you haven’t seen a case like the one going on at a Mott’s apple juice factory that you’ve been called in to consult on.

Mott’s, a division of Dr. Pepper Snapple Group, employs 305 people at its juice factory in Williamson, N.Y., near Rochester. All 305 employees, however, have been on strike for more than 3 months. They are protesting the fact that the company wants to make severe cuts in pay and benefits—a reduction of wages by $1.50 (about $3,000 per year), a pension freeze, a reduction in 401K contributions, and a decrease in the health insurance subsidy.

On the surface, these cuts seem to make some business sense, because companies all over the world are struggling. But what is so unusual in this case is that Dr. Pepper Snapple Group is more profitable than it ever has been. In the last year, its net income was $550 million, a dramatic improvement from the previous year, when it lost $312 million. Because of this success, employees are accusing the company of being greedy. Stuart Applebaum, the president of the factory workers’ union, says “[Dr. Pepper Snapple doesn’t] even show the respect to lie to us. They just came in and said, ‘We have no financial need for this, but we just want it anyway because we figure we can get away with it.’”

The company, meanwhile, defends the pay and benefits cut by arguing that its current labor costs are considerably higher than other local companies. The average pay at the Mott’s plant is $21, whereas other factories and transportation companies in the area pay closer to $14. In a public statement, the company defends the move, saying in part, “As a public company, Dr. Pepper Snapple Group has a fiduciary responsibility to operate in the best interests of all its constituents, recognizing that a profitable business attracts investment, generates jobs and builds communities.”

You have been assigned to a task force with representatives from management and labor that has been charged with resolving the crisis. As all of you review the files, you realize this is a critical case; if the employees lose, other companies might be motivated to take similar actions and cut labor costs (and increase profits) even when they are not struggling financially.

For this Management Team Decision, form a group of three or four with other students, to act as the task force, and answer the following questions.

Source:

Steven Greenhouse “In Mott’s Strike, More than Pay at Stake” *The New York Times*, August 17, 2010, accessed October 10, 2010, from [www.nytimes.com/2010/08/18/business/18motts.html?\_r=1&adxnnl=1&adxnnlx=1297947774-W3u9XoLkFQ6q+a7OmuVx1A](http://www.nytimes.com/2010/08/18/business/18motts.html?_r=1&adxnnl=1&adxnnlx=1297947774-W3u9XoLkFQ6q+a7OmuVx1A)**.**

**Questions**

1. How could you help steer negotiations between labor and management so that the conflict between them is healthy and productive? Is that even possible?   
     
   Rather than one side looking for domination, or for both parties to lose something by compromising, Mary Parker Follett wrote that they should pursue integrative conflict resolution. In this process, both parties in the conflict indicate their preferences and then work together to find an alternative that meets the needs of both. In the case of the Mott’s factory, the company wants to establish some costs control, while the employees reasonable salaries, benefits, and assurance that their jobs will be safe. Rather than solving the problem by giving one party (or the other) all that it wants, integrative conflict resolution can be used so that the parties reach a third alternative.
2. Is the company justified in trying to cut costs even when it has made a huge profit? Are the employees justified in not working to protest what they perceive as unfair cuts?   
     
   Students’ responses will vary. Likely, some will side with the company, reasoning that a company has the right to use its resources as it so chooses. On the other hand, some groups will argue that companies have a certain responsibility to its employees.

### Practice Being a Manager

#### OBSERVING HISTORY TODAY

The topic of management history may sound like old news, but many of the issues and problems addressed by Max Weber, Chester Barnard, and other management theorists still challenge managers today. *How can we structure an organization for maximum efficiency and just treatment of individuals? What is the basis for, and limits to, authority in organizations?* It is rather amazing that these thinkers of the late 19th and early 20th centuries generated such a wealth of theory that still influences our discussion of management and leadership challenges in the 21st century. This exercise will give you the opportunity to draw upon some ideas that trace their roots back to the pioneers of management thinking.

##### Preparing in Advance for Class Discussion

**Step 1: Find an observation point.** Identify a place where you can unobtrusively observe a group of people as they go about their work. You might select a coffee shop, bookstore, or restaurant.

**Step 2: Settle in and observe.** Go to your selected workplace and observe the people working there for at least 20 minutes. You should take along something like a notebook or PDA so that you can jot down a few notes. It is a good idea to go during a busy time, so long as it is not so crowded that you will be unable to easily observe the workers.

**Step 3: Observe employees at work.** Observe the process of work and the interaction among the employees. Consider some of the following issues:

* Identify the steps that employees follow in completing a work cycle (e.g., from taking an order to delivering a product). Can you see improvements that might be made, particularly steps that might be eliminated or streamlined?
* Observe the interaction and mood of the workers. Are they stressed? Or are they more relaxed? Does it seem to you that these workers like working with each other?
* Listen for signs of conflict. If you see signs of conflict, is the conflict resolved? If so, how did the workers resolve their conflict? If not, do you think that these workers suppress (bottle up) conflict?
* Can you tell who is in charge here? If so, how do the other workers respond to this person’s directions? If not, how does the work group sort out who should be doing each task, and in what order?

**Step 4: Consider what you saw.** Immediately after your observation session, look through this chapter on management history for connections to your observations. For example, do you see any signs of the “Hawthorne Effect”? Would Fredrick Taylor approve of the work process you observed, or might he have suggested improvements? What might Chester Barnard’s theory have to say about how the workers you observed responded to instructions from their “boss”? Write a one-page paper of bullet-point notes describing possible connections between your observations and the thinking of management pioneers such as Mary Parker Follett.

##### Class Discussion

**Step 5: Share your findings as a class.** Discuss the various points of connection you found between pioneering management thinkers and your own observations of people at work. Are some of the issues of management “timeless”? If so, what do you see as timeless issues of management? What are some ways in which work and management *have changed* since the days of the management pioneers?

#### TEACHING NOTES––PRACTICE BEING A MANAGER

##### Exercise Overview and Objective

In this exercise, students will spend some time (20 minutes minimum) observing people at work. The objective of this exercise is for students to see—in a live context—the problems and challenges that interested management thinkers of the past. One of the most basic starting points for understanding the field of management is simply to observe *people at work*. Observation was the starting place for such pioneers as Fredrick Taylor, Charles Barnard, and Max Weber. And it is the starting place for many of today’s most influential management scholars. Also, this exercise should help students understand that historical contributions were made by pioneering individuals who wrestled with questions and issues that continue to challenge management thinkers today.

Assign Step 1 at least one class session prior to the session in which you would like to complete this exercise. You may want to allow more time, as the observation requires students to identify an appropriate site and unobtrusively observe work there for at least 20 minutes. You may want to explain “unobtrusive.” Students should be able to naturally observe the work at this site for at least 20 minutes without drawing attention to themselves or otherwise changing the natural flow of work. Some good examples are given in the instructions to Step 1:

* Coffee Shop
* Bookstore
* Restaurant

These worksites are places where patrons commonly hang out and enjoy a latte or browse the bookshelves. You may want to caution students not to attempt to spy on anyone and/or to misrepresent themselves to a security guard, manager, etc. It is ethical to observe work/workers in public spaces but a serious ethical violation to spy on workers in private spaces and/or to misrepresent one’s intentions. Students may want to number or otherwise identify workers (e.g., Worker 1, Manager, and Worker 2). Students should use a shorthand (e.g., W-2 for Worker 2) to ease note taking. Discourage students from using real names or other means of personal identification and from recording anything of a sensitive/private nature. Instead of capturing the word-by-word dialogue of two workers gossiping about a third worker, simply record “W-1 and W-2 in private conversation for 3 minutes.”

Announce that students should read the bullet items in Step 3 before they arrive at their place of observation. This will help them to know what they are watching for and also to better organize their observation notes. Finally, remind student that Step 2 instructs them to take along whatever they need to take notes (e.g., notepad, PDA).

The one-page paper (see Step 4) should be completed as soon after the observations as possible. It is best if students plan to write this paper immediately after their observations.

**In-Class Use**

Class discussion should follow the submission of the papers. Some instructors prefer to read the papers and discuss them in a subsequent session. Other instructors prefer to discuss the findings on the day the papers are submitted. Either approach is fine here, so long as the time lag between student observations and class discussion is kept to a minimum.

The class discussion may proceed in a linear fashion through the major sections of the chapter, with discussion of connections to the student observations by section. Alternatively, you may want to lead a nonlinear discussion of students’ observations/connections. In either case, discussion should aim to:

* Share the experience of observing people at work—what might observation contribute to our understanding (vs., say, reading about a particular workplace)?
* Identify at least a few of the timeless themes in management study. (See the questions in Step 4 of the exercise related to the Hawthorne Effect, Chester Barnard’s theory on acceptance of authority, etc.)
* Identify at least a few of the ways in which work and management may have changed since the era when studied by the pioneers in management thought (e.g., shifts in communication driven by email, computer networks).

### Develop Your Career Potential

**Purpose**

This assignment is designed to encourage students to begin tracking management trends and theories on a daily basis. As patterns emerge, students will better be able to anticipate shifts in management ideas prompted by changes in the complex general and specific environments.

**Organizing the Discussion**

Students are given three activities: finding a press article that discusses some of the topics covered in the book (all chapters), writing a brief summary of that article and researching unfamiliar terms, and situating the material in the context of the history presented in Chapter 2 (if possible).

One way to use this activity in class starts by having each student give a single-sentence description of his or her article and identify the periodical in which it was published and the date. Doing this, students will be able to listen for recurring themes and think about them in a temporal fashion. Then, write or project the table of contents on the board. Ask students to raise their hand when you call out a chapter to which they think their article relates. Students may raise their hand more than once, depending on the article they read. Alternatively, after students give their brief summaries, you can simply indicate which chapters seem to be more frequently represented. Divide the students into groups based on the chapters to which their articles most closely relate. In small groups, have each student share his or her brief summary and how each thinks the subject of the article relates to the management theories presented in the chapter. Ask each group to think about implications of the articles or conclusions they can draw about how their topic is evolving in the real world. For example, if a group of students chose articles on teams and teamwork, can it draw any conclusions about challenges (or lack thereof) companies seem to be facing when implementing teams?

Another way to organize the discussion is to ask students about the connections they made between management history and current management news. Ask if, based on their article, they think historical management theories are relevant for today’s workforce. If they answer yes, have them say why. If they answer no, ask them to explain why not.

Remind students that most business periodicals have sections related to management. The *Wall Street Journal* has features titled “Cubicle Corner,” “In the Jungle,” “Work and Family,” and others that focus on management issues. *Fortune* has regular features like “Ask Annie,” and *Fast Company* includes a column called “Corporate Shrink” and an interview with a manager called “What I Know Now.”

#### KNOW WHERE MANAGEMENT IS GOING

As you read in the chapter, management theories are dynamic. In other words, they change over time, sometimes very rapidly. In addition, management theories have often been cumulative, meaning that later theorists tend to build on theories previously advanced by other scholars. Thus, a new theory becomes the starting point for yet another theory that can either refine or refute the management thinking of the day. One way to prepare for your career as a manager is by becoming aware of management trends today. The best (and easiest) way to do that is by regularly combing through business newspapers and periodicals. You will always find at least one article that relates to management concepts, and as you scan the business press over time, you will see which theories are influencing current management thinking the most. By understanding management history and management today, you will be better able to anticipate changes to management ideas in the future. This exercise is designed to introduce you to the business press and to help you make the connection between the concepts you learn in the classroom and real-world management activities. Done regularly, it will provide you with invaluable insights into business activities at all types of organizations around the world.

**Activities**

1. Find a current article of substance in the business press (for example, the *Wall Street Journal,* the *Financial Times, Fortune, BusinessWeek, Inc.*) that discusses topics covered in this course. Although this is only Chapter 2, you will be surprised by the amount of terminology you have already learned. If you are having trouble finding an article, read through the table of contents on pages iv–viii to familiarize yourself with the names of concepts that will be presented later in the term. Read your article carefully, making notes about relevant content.

2. Write a one-paragraph summary of the key points in your article. List the terms or concepts critical to understanding the article, and provide definitions of those terms. If you are unfamiliar with a term or concept that is central to the article, do some research in your textbook or see your professor during office hours. Relate these key points to the concepts in your text by citing page numbers.

3. How does your article relate to the management theories covered in this chapter? Explain the situation detailed in your article in terms of the history of management.

### Reel to Real Video Assignment: Management Workplace

Management Workplace videos can support several in-class uses. In most cases you can build an entire 50-minute class around them. Alternatively, they can provide a springboard into a group lesson plan. The Management Workplace video for Chapter 2 would be a nice companion to your introduction to the course on the first day teaching this chapter.

**Video:** **Barcelona Restaurant Group**

The Evolution of Management Thinking

Summary:

Andy Pforzheimer is himself a renowned chef and the co-owner of Barcelona Restaurant Group, a collection of seven wine and tapas bars in Connecticut and Atlanta, Georgia. When customers dine at any of Pforzheimer’s restaurants, they experience the local color and personal touch of a neighborhood eatery. The wait staff is personable and strives to get to know customers’ tastes. Delivering this unique dining experience requires a unique approach to management. The company gives employees the freedom and control they need to impress customers. It recruits self-confident individuals who can take ownership over the establishment and its success. Further, Pforzheimer is adamant that his staff be mature and willing to take responsibility for their work and success.

Discussion Questions from Prepcard:

1. What aspects of restaurant work are especially challenging to wait staff, and how does Barcelona’s approach to management help employees overcome the downsides of the job?

In the video, Andy Pforzheimer identifies the challenging aspects of restaurant life: “It is work sometimes to smile. It is work to have somebody yelling at you because they weren’t seated fast enough or their steak was cooked wrong, and you must pat them on the back and say, ‘You know, it was our fault, I’ll do everything I can’—yeah, that’s work, and it’s not always fun.”

Barcelona’s leadership team believes such challenging aspects of restaurant work can be managed best when employees are given significant responsibility over the restaurant and its success. New hires learn at the outset that the restaurant is their responsibility, and if the place does well, the members of the wait staff get all the credit.

1. What steps do the leaders of Barcelona Restaurant Group take to insure cooperation and acceptance of authority from their employees?

Andy Pforzheimer says that he accepts other’s opinions, wants managers to communicate with him at all times, and wants to hire people who are self-starting. He allows people in his company to use their creativity to come up with innovative solutions. Rather than telling people what to do and how to do it, the leadership at Barcelona expects all employees to make their own decisions about what they think will be the best for the company and best for the customer. Pforzheimer also insures cooperation and acceptance of authority by setting clear goals and standards. At Barcelona, everything is about customer satisfaction, and achievement is defined as giving the cusomter a great dining experience. Whatever authority Pforzheimer exericses over employees is centered on that goal.

1. Would the management style of Barcelona Restaurant Group best be described as scientific management or contingency management?

The leadership at Barcelona is looking for people who are comfortable taking ownership. The leaders want people who can make their own decisions instead of having to be told how to do everything. In this way, Barcelona aims to be the opposite of other restaurants, in which every procedure and action is regulated. Barcelona employees are empowered to make guests happy, and the leadership of the company puts a high degree of emphasis on the contributions that everyone can make. In this way, Barcelona reflects the contingency approach to management, which clearly states that there are no universal management theories and that the most effective management theory or idea depends on the kinds of problems or situations that managers or organizations are facing at a particular time. In short, the best way depends on the situation.

### Review Questions

1. Why do modern companies need managers?

Different from cottage industries and craftsmen, modern companies employ thousands of workers (unskilled, skilled, and professional) who produce both standardized and customized products and services. As a result, managers are needed to impose order and structure, to motivate and direct these large groups of workers, and to plan and make decisions that optimize overall company performance by effectively coordinating the different parts of complex organizational systems.

1. How are historical management ideas and practices related to the topics you will study in this textbook?

Each management theorist presented in Chapter 2 has left his or her imprint on modern management study. Therefore, throughout this book, you will experience the extensions of many of their theories. Henri Fayol’s classic management functions—distilled down to planning, organizing, leading, and controlling—provide the underlying architecture for the contents of the book. Frederick Taylor’s scientific management theories have implications for issues of job design and specialization covered in Chapter 9, teamwork covered in Chapter 10, and compensation covered in Chapter 11. Henry Gantt’s contributions are evoked in Chapter 6 on planning and decision making, and Mary Parker Follett’s work resurfaces in Chapter 5 in the section on group decision making and managing conflict, and in Chapter 10 on teams. Elton Mayo’s work informs Chapter 10 on managing teams, and Chester Barnard’s theories can be seen in Chapter 9 on designing organizational structures. Systems management is covered in Chapter 5, information management in Chapter 17, and operations management in Chapter 18.

As you can see, the early management theories are still providing a foundation on which the modern study of management is being built.

1. Explain the contributions of Taylor, the Gilbreths, and Gantt to the theory of scientific management.

In contrast to seat-of-the-pants management, scientific management recommended studying and testing different work methods to identify the best, most efficient ways to complete a job. According to Frederick W. Taylor, the father of scientific management, managers should follow four scientific management principles to find “one best way” to do it. First, “develop a science” by studying each element of work to determine the one best way for each element. Second, scientifically select, train, teach, and develop workers to reach their full potential. Third, cooperate with employees to ensure implementation of the scientific principles. Fourth, divide the work and the responsibility equally between management and workers. Above all, Taylor felt these principles could be used to align managers and employees to determine “a fair day’s work,” what an average worker could produce at a reasonable pace. Once that was determined, it was management’s responsibility to pay workers fairly for that effort. Taylor believed incentives were one of the best ways to align management and employees.

The husband and wife team of Frank and Lillian Gilbreth are best known for their use of motion studies to simplify work. While Taylor used time study and how long it took a “first-class man“ to complete each part of his job to determine “a fair day’s work,” the Gilbreths used film cameras and microchronometers to conduct motion study to improve efficiency by categorizing and eliminating unnecessary or repetitive motions. Lillian Gilbreth, one of the first contributors to industrial psychology, established ways to improve office communication, incentive programs, job satisfaction, and management training. Her work also convinced the government to enact laws regarding workplace safety, ergonomics, and child labor.

Henry Gantt is best known for the Gantt chart, which graphically displays when a series of tasks must be completed to perform a job or project, but he also developed ideas regarding pay-for-performance plans (where workers were rewarded for achieving higher levels, but not punished if they didn’t) and worker training (all workers should be trained and their managers should be rewarded for training them).

1. Compare bureaucratic and administrative management.

German sociologist Max Weber is credited with the development of bureaucracy and bureaucratic management theories. That is, running organizations on the basis of knowledge, fairness, and logical rules and procedures rather than on the basis of nepotism, the prospects for personal gain, and arbitrary decision making. Bureaucracies are characterized by seven elements: qualification-based hiring; merit-based promotion; chain of command; division of labor; impartial application of rules and procedures; all administrative decisions, acts, rules, or procedures are recorded in writing; and managers are separate from owners. Nonetheless, bureaucracies are often inefficient and can be highly resistant to change.

Administrative management was the brainchild of Frenchman Henri Fayol, who argued that the success of an organization depended more on the administrative ability of its leaders than on their technical ability. Out of that postulate, Fayol developed 5 management functions (planning, organizing, coordinating, commanding, and controlling) and 14 principles of management (division of work, authority and responsibility, discipline, unity of command, unity of direction, subordination of individual interests to the general interest, remuneration, centralization, scalar chain, order, equity, stability of tenure of personnel, initiative, and esprit de corps). He is also known for his belief that management could and should be taught to others.

1. Explain the principles of Mary Parker Follett’s human resource management.

Unlike most people who view conflict as bad, Mary Parker Follett, the mother of modern management, believed that conflict could be beneficial, that it should be embraced and not avoided, and that, of the three ways of dealing with conflict (domination, compromise, and integration), the latter was the best because it focuses on developing creative methods for meeting conflicting parties’ desires. Follett also used four principles to emphasize the importance of coordination where leaders and workers at different levels and in different parts of the organization directly coordinate their efforts to solve problems and produce the best overall outcomes in an integrative way. Her work added significantly to modern understandings of the human, social, and psychological sides of management.

1. What lessons did we learn from the Hawthorne studies? Summarize Barnard’s contributions on cooperation and acceptance of authority.

The Hawthorne Studies conducted at the Western Electric Company occurred in several stages. In the first stage of the Hawthorne Studies, production went up because the amount and quality of attention paid to the workers in the study and their development into a cohesive work group led to significantly higher levels of job satisfaction and productivity. In the second stage, productivity dropped because the workers been an existing work group for some time and had already developed strong negative norms, in which individual rate busters who worked faster than the rest of the team were ostracized or “binged” (hit on the arm) until they slowed their work pace. The Hawthorne Studies demonstrated that workers were not just extensions of machines (workers’ feelings and attitudes affected their work), that financial incentives weren’t necessarily the most important motivator for workers, and that group norms and behavior play a critical role in behavior at work.

Chester Barnard emphasized the critical importance of willing cooperation in organizations, noting that most managerial requests or directives will be accepted because they fall within the zone of indifference. Ultimately, he says, workers grant managers their authority, not the other way around.

1. Discuss the contributions of Whitney and Monge to operations management.

Operations management uses a quantitative or mathematical approach to find ways to increase productivity, improve quality, and manage or reduce costly inventories. Eli Whitney invented the concept of interchangeable parts, which ultimately led to companies being able to standardize products and produce them in mass quantities. Efficient standardization, however, would not have been possible without the contributions of Gaspard Monge, who developed and outlined techniques for proportional rendering of three-dimensional objects. Monge’s drafting techniques are the foundation of modern CAD (computer-aided drafting) and CAM (computer-aided manufacturing capabilities).

1. How do companies use systems management to make sense of organizational and environmental complexity?

Organizational systems obtain inputs from the general and specific environments. Rather than viewing one part of an organization as separate from the other parts, a systems approach encourages managers to look for connections between the different parts of the organization. The systems approach also forces managers and workers to view their organization as part of and subject to the competitive, economic, social, technological, and legal/regulatory forces in their environment. Managers then use knowledge gained from those understandings to create products and services, which are then consumed by persons or organizations in the environment. Then, those consumers provide feedback to the organization, allowing managers and workers to modify and improve their products or services.

1. Identify the major milestones in the history of managing information.

Historically, some of the most important technologies that have revolutionized information management were the use of horses by post messengers in Italy in the 1400s, the creation of paper and the printing press in the 14th and 15th centuries, the manual typewriter in 1850, the telegraph in the 1860s, cash registers in 1879, the telephone in the 1880s, the personal computer in the 1980s, and the Internet in the 1990s.

1. Explain contingency management.

The contingency approach to management clearly states that there are no universal management theories and that the most effective management theory or idea depends on the kinds of problems or situations that managers or organizations are facing at a particular time. This type of management is much harder than it looks and because managers must look for key contingencies that differentiate today’s situation or problems from yesterday’s situation or problems by spending more time analyzing problems and situations before they take action to fix them.