



# Business Startup and Entrepreneurship: Canada







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**Matthew Pauley**





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This book was produced with Pressbooks (<https://pressbooks.com>) and rendered with Prince.

# Dedication

*I dedicate this textbook to my wife Sarah, who  
inspires me to pursue my passions and dreams.*





Dr. Matthew Pauley is an Assistant Professor of Entrepreneurship at the [University of Prince Edward Island](#), and is an award-winning teacher with a professional teaching designation (Associate Fellow of the Higher Education Academy). He completed his PhD in Entrepreneurship from the University of St Andrews and holds a Master of Business Administration from the University of South Dakota. Matthew hopes to promote equity, diversity, and inclusivity, especially through content development that is accessible and accommodating to all people, especially those with varying learning abilities.

Matthew has been a Visiting Researcher (Dublin City University), Visiting Lecturer (University of Canada), and has over 20 years experience as an entrepreneur. His primary research interest is in entrepreneurial exits, micro/small and family business on topics of wellbeing, exit decision-making, succession, and “every day” entrepreneurs. Current research projects include family succession in the Irish and Atlantic Canadian lobster fishing industry; Historical Perspectives of

Indigenous Entrepreneurs; Maritime Bus Case Study; and Social Networks in Financial Harvests. He has presented papers at international conferences; supports student initiatives and offers consulting.

For further information, please visit: [www.matthewpauley.ca](http://www.matthewpauley.ca); [LinkedIn](#)

A handwritten signature in black ink, reading "Matthew Pauley". The signature is fluid and cursive, with the first name "Matthew" and last name "Pauley" clearly distinguishable.

**Matthew Pauley PhD MBA AFHEA**

Assistant Professor of Entrepreneurship

Director of the Hostetter Centre for Enterprise and Entrepreneurship

Leader – Global Entrepreneurship Monitor, Prince Edward Island

Division Editor – Entrepreneurship, *The Workplace Review*

*I acknowledge that UPEI resides on the unceded land of the Mi'kmaq Nation, of the Wabanaki Confederacy, in the traditional district of Epikwitk, and we are grateful for the opportunity to share knowledge on their ancestral land.*

# Acknowledgements

I am sincerely grateful to Kim Mears and Donald Moses from Robertson Library, who have provided their insight, understanding, and passion into the development of Open Educational Resources and shared commitment to making information more accessible while reducing educational costs. Thank you to the many creatives who contributed photos, videos, and content for this textbook under free-to-use licenses.

I would also like to thank my wife, Sarah, our dog Jack, and families for the support and encouragement throughout the duration of this project.

# Preface

Given the financial challenges students face in higher education, my hope with this textbook is to draw on my 20+ years of entrepreneurship experience and academic research to compile resources that reflect the general aspects of starting a business. *Business Startup and Entrepreneurship: Canada* is an Open Educational Resource (OER) textbook that focuses on the practical, current, and relevant topics associated with starting a business in Canada. This broad practical approach allows instructors to introduce these simple chapters to build a basic understating of the essentials to startups.



# Introduction

## **Business Plan Workbook and Excel Worksheet**

Along with this textbook is an accompanying Business Plan Workbook, helping students to work through a business idea chapter-by-chapter that hopefully culminates in a well thought-through startup plan. In my experience teaching introductory entrepreneurship courses, developing a business plan supports deep-level learning that is displayed through critical analysis, creativity, and networking. The design of the business plan has been simplified and tested over the past three years with over 750 students from diverse cultures and academic disciplines. It is my recommendation that students work on the business plan throughout the duration of the course as they complete chapters to reaffirm important lessons. Students may find tasks such as finance and accounting difficult, which is why an Excel Worksheet accompanies the business plan to help prepare financial reports for their proposed businesses.



# 1/ The Fundamentals of Business

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SOURCE: [Pxfuel](#).

## *Learning Objectives*

- *Understand the basic foundations of business.*
- *Define types of business.*

- *Discuss basic concepts of economic ecosystems.*

## ***Business Basics***

This module provides the basic structures of business, its organization, outside forces influencing it, and where it is heading in North America. It also explores how the world's economies and governments shape economic activity. Each day in the United States, thousands of new businesses are born. Only a rare few will become the next Apple, Google, or Amazon. Unfortunately, many others will never see their first anniversary. The survivors are those that understand that change is the one constant in the business environment. Those organizations pay attention to the business environment in which they operate and the trends that affect all businesses and then successfully adapt to those trends. In this module, we will meet many businesses, both large and small, profit and not-for-profit, that prosper because they track trends and use them to identify potential opportunities.

## **The Nature of Business**

We begin our study of business by introducing you to the primary functions of a business, the relationship between risk and profits, and the importance of not-for-profit organizations. We address the following topics:

- Examine the major components of the business

environment and how changing demographic, social, political, and legal, and competitive factors affect all business organizations.

- Explore how economies provide jobs for workers and compete with other businesses to create and deliver products to consumers.
- Understand how governments attempt to influence economic activity through policies such as lowering or raising taxes.
- Discuss how supply and demand determine prices for goods and services.
- Examine key trends in the business environment, economic systems, and the competitive environment.

## How do businesses and not-for-profit organizations help create our standard of living?

Take a moment to think about the many businesses you encounter on a typical day. As you drive to class, you may stop at a gas station that is part of a major national oil company and grab lunch from a fast food chain such as Taco Bell or McDonald's or the neighbourhood pizza place. Need more cash? You can do your banking on a smartphone or other device via mobile apps. You do not even have to visit the store anymore: online shopping brings the stores to you, offering everything from clothes to food, furniture, and concert tickets.

A business is an organization that strives for a profit by providing goods and services desired by its customers. Businesses meet the needs of consumers by providing medical care, autos, and countless other goods and services. Goods are tangible items manufactured by businesses (i.e. laptops). Services are intangible (no physical presence) offerings of

businesses. Physicians, lawyers, hairstylists, car washes, and airlines all provide services. Businesses also serve other organizations like hospitals, retailers, and governments, by providing machinery, goods for resale, and other items.



SOURCE: [Pxfuel](#).

Businesses create the goods and services that are the basis of our standard of living. The output of goods and services people can buy with the money they have measures the **standard of living**. The United States has one of the highest standards of living in the world. Countries like Switzerland and Germany have higher average wages than the United States, their standards of living are not higher, because prices are so much higher, meaning the same amount of money buys less in those countries. The Economist website ([link](#)) has a current ranking of standards of living by country.

Businesses play a key role in determining our quality of life by providing jobs and goods and services to society. Quality of life refers to the general level of human happiness based on such things as life expectancy, educational standards, health, sanitation, and leisure time. Building a high-quality of life is a combined effort of businesses, government, and not-for-profit organizations. In 2017, Vienna, Austria, ranked highest in quality of life, followed by Zurich, Switzerland; Auckland, New Zealand;

and Munich, Germany. It may come as a surprise that not one of the world's top cities is in the United States: seven of the top 10 locations are in western Europe, two are in Australia/New Zealand, and one is in Canada. At the other end of the scale, Baghdad, Iraq, is the city scoring the lowest on the annual survey.<sup>1</sup>



SOURCE: [Julius Silver](#).

Creating a quality of life is not without risks, however. Risk is the potential to lose time and money or otherwise not be able to accomplish an organization's goals. Without enough blood donors, the American Red Cross faces the risk of not meeting the demand for blood by victims of disaster. Businesses such as Microsoft face the risk of falling short of their revenue and profit goals. Revenue is the money a company receives by providing services or selling goods to customers. Costs are expenses for rent, salaries, supplies, transportation, and many other items that a company incurs from creating and selling goods and services. Some costs incurred by Microsoft in developing its software include expenses for salaries, facilities, and advertising. If Microsoft has money left over after it pays all costs, it has a profit. A company whose costs are greater than revenues show a loss.

Microsoft uses its resources intelligently, often

increasing sales, holding costs down, and earning a profit. Not all companies earn profits, but that is the risk of being in business. In North American businesses today, there is generally a relationship between risks and profit: the greater the risks, the greater the potential for revenue (or loss). Companies that take too conservative a stance may lose to more nimble competitors who react quickly to the environment.



SOURCE: [Pexels](#).

Take Sony, the Japanese electronics giant, once a leader with its Walkman music player and Trinitron televisions, steadily lost ground (and profits) over the past two decades to other companies by not embracing new technologies such as the digital music format and flat-panel TV screens. Sony misjudged what the market wanted and stayed with proprietary technologies rather than create cross-platform options for consumers. Apple, at the time an upstart in personal music devices, quickly grabbed the lion's share of the digital music market with its iPods and iTunes music streaming service. By 2016, Sony restructured its business portfolio and has experienced substantial success with its PlayStation 4 gaming console and original gaming content.<sup>2</sup>



# Non-profit Organization

*Not all organizations strive to make a profit. A not-for-profit organization is an organization that exists to achieve some goal other than the usual business goal of profit. Charities such as Habitat for Humanity, the United Way, the American Cancer Society, and the World Wildlife Fund are not-for-profit organizations, as are most hospitals, zoos, arts organizations, civic groups, and religious organizations. Over the last 20 years, the number of non-profit organizations, employees, and the volunteers who work for them has increased considerably. Government is our largest and most pervasive not-for-profit group. Over 1.5 million nongovernmental not-for-profit entities operate in the United States today and contribute more than \$900 billion annually.*<sup>3</sup>



SOURCE: [Pxfuel](#).

Like their for-profit counterparts, these groups set goals and require resources to meet those goals (but not profit-driven). A not-for-profit organization's goal might feed the poor, preserving the environment, increasing attendance at the ballet, or preventing drunk driving. These organizations

*do not compete directly with one another like Ford and Honda, but compete for talented employees, volunteer time, and donations.*

*Hurricane Irma affected the island of Puerto Rico, the Kentucky, and Hawaii National Guard assisted storm victims by donating to disaster relief efforts. Some not-for-profit charities focused aid toward the people of the region, but others delivered care to sufferers: animals and pets. Most animal hospitals are not normally a refuge for displaced animals, many facilities opened their doors to pet owners affected by the torrential rains.*

*The boundaries that formerly separated not-for-profit and for-profit organizations have blurred, leading to a greater exchange of ideas between the sectors. For-profit businesses are now addressing social issues. Successful not-for-profits apply business principles to operate effectively. Not-for-profit managers concern themselves with the same concepts as their colleagues in for-profit companies: developing strategy, budgeting carefully, measuring performance, encouraging innovation, improving productivity, demonstrating accountability, and fostering an ethical workplace environment.*

*Top executives manage the administrative and business side of the organization: human resources, finance, and legal concerns. Ticket revenues cover a fraction of the museum's operating costs, so the director spends a great deal of time seeking major donations and memberships. Today's museum boards of directors include both art patrons and business executives who want to see sound fiscal decision-making in a not-for-profit setting. A museum director must walk a fine line between the institution's artistic mission and financial policies. According to a survey by The Economist, over the next several years, major art museums will look for new directors, as more than a third of the current ones are approaching retirement.*<sup>4</sup>

Table 1. Charity versus Non-Profit Organization

Topic	Registered Charity	NPO
Purposes	established and operate only for charitable purposes	can operate for social welfare, civic improvement, pleasure, sport, recreation, or any other purpose except profit
Registration	must apply to the CRA and approved for “charity” registration	does not have to go through a registration process for income tax purposes
Charitable registration number	given a charitable <a href="#">registration number</a> once approved by CRA	is not given a charitable registration number
Tax receipts	can issue official donation receipts for income tax purposes	cannot issue official donation receipts for income tax purposes
Spending requirement	must spend a minimum amount on its own charitable activities or as gifts to <a href="#">qualified donees</a>	does not have a spending requirement
Designation	CRA designates a charitable organization, a public foundation, or private foundation	does not receive a designation
Returns	must file an annual information return (Form T3010) within six months of its fiscal year-end	may have to file a T2 return (if incorporated) or an information return (Form T1044) or both within six months of its fiscal year-end
Personal benefits	cannot use income for personal benefit or members	cannot use income for personal benefit or members

Tax-exempt status	is exempt from paying income tax	generally exempt from paying income tax may have to pay tax on property income or on capital gains
GST/HST	usually pay GST/HST on purchases may claim a partial rebate of GST/HST paid on eligible purchases most supplies made by charities are exempt calculates net tax using <a href="#">the net tax calculation for charities</a>	must pay GST/HST on purchases may claim a partial rebate of GST/HST paid on eligible purchases only if it receives significant government funding few supplies made by NPOs are exempt calculates <a href="#">net tax</a> the regular way

SOURCE: [Government of Canada, 2016](#).

In Prince Edward Island, non-profit organizations can be incorporated by letters patent under Part II of the *Companies Act*. Non-profit companies have members but do not share capital. The provincial government has dedicated resources to support non-profit organizations on their website ([link](#)), including affordable housing, green space initiatives, and hardware like computers for co-operatives and non-profits alike. In Canada, non-profit organizations are clubs, societies, or associations that operate solely for social welfare, civic improvement, pleasure/recreation, or any other purpose except for-profit.<sup>5</sup>

Unlike non-profits, Canadian charities must use their resources for charitable activities and purposes that fall into one or more of the following categories:

- *relief of poverty*
- *advancement of education*
- *advancement of religion*
- *other purposes that benefit the community*

*Examples of charities include:*

- *relief of poverty (food banks, soup kitchens, and low-cost housing units).*
- *advancement of education (colleges, universities, and research institutes).*
- *advancement of religion (places of worship and missionary organizations).*
- *purposes beneficial to the community (animal shelters, libraries, and volunteer fire departments).*<sup>6</sup>

## **Factors of Production: Foundation of Business**

To provide goods and services, organizations require factors of production (resources). Four traditional factors of production are common to all productive activity: *natural resources*, *labour (human resources)*, *capital*, and *entrepreneurship*. Many experts now include *knowledge* as a fifth factor, acknowledging its key role in business success. By using the factors of production efficiently, a company can produce more goods and services with the same resources.

***Natural resources*** are useful input commodities in their natural state, including farmland, forests, mineral and oil deposits, and water. Sometimes natural resources are “land,” although the term means more than just land. Companies use natural resources in different ways like the International Paper Company using wood pulp to make paper or Pacific Gas Electric Company using water, oil, or coal to produce electricity. Today urban sprawl, pollution, and limited resources have raised questions about resource use. Conservationists, environmentalists, and government bodies are proposing laws to require land-use planning and resource conservation.

***Labour***, or human resources, refers to the economic

contributions of people working with their minds and muscles. This input includes the talents of everyone (from a restaurant cook to a nuclear physicist) who performs the many tasks of manufacturing and selling goods and services. **Capital** is the tools, machinery, equipment, and buildings used to produce goods and services and get them to the consumer. Sometimes the term *capital* is also used to mean the money that buys machinery, factories, and other production and distribution facilities. Money itself produces nothing, it is not one of the basic inputs as it is a means of acquiring the inputs and not money.

**Entrepreneurs** are the people who combine the inputs of natural resources, labour, and capital to produce goods or services to make a profit or accomplishing a not-for-profit goal. These people make the decisions that set the course for their businesses; they create products and production processes or develop services. There is no guarantee their time and effort are profitable, but if successful, can create great wealth.

Today, many individuals want to start their own businesses as media often prop entrepreneurship, wealth, and personal prestige. Many start their first business from their dorm rooms (i.e. Mark Zuckerberg of Facebook), or while living at home, so their cost is almost zero. Entrepreneurs include people such as Microsoft cofounder Bill Gates (the richest person in the world in 2017), and Google founders Sergey Brin and Larry Page. Micro-, small-, and medium-sized business account for most businesses operating globally, making significant contributions (local through to global markets).

Several outstanding managers and noted academics are emphasizing a fifth factor of production, knowledge. Knowledge refers to the combined talents and skills of the workforce and has become a primary driver of economic growth. Today's competitive environment places a premium on knowledge and learning over physical resources. Recent statistics suggest that the number of U.S. knowledge workers

has doubled over the last 30 years, with about 2 million knowledge job openings annually. Automation has replaced many “routine” jobs over the last decade or outsourced to other countries, technology has actually created more jobs that require knowledge and cognitive skills.

### *Exercises*

- Explain the concepts of revenue, costs, and profit.
- What are the five factors of production?
- What is the role of an entrepreneur in society?

### *Key Takeaways*

Businesses attempt to earn a profit by providing goods and services desired by their customers. Not-for-profit organizations, though not striving for a profit, still deliver many needed services for our society. The output of goods and services measures our standard of living. Businesses and not-for-profit organizations help create our standard of living. Our quality of life is not simply the amount of goods and services available for consumers but the society’s general level of happiness.

Economists refer to the building blocks of a



business as the factors of production. To produce anything, one must have natural resources, labour (human resources), capital, and entrepreneurship to assemble the resources and manage the business. Today's competitive business environment requires knowledge and learning. The companies that succeed will be those that learn fast, use knowledge efficiently, and develop new insights.

## Footnotes

1 “Mercer 2017 Quality of Life Rankings,” <http://mercer.com/qol>, May 15, 2017.

2 Rob Fahey, “Sony’s Entire Future Now Rests on PlayStation,” <http://www.gamesindustry.biz>, July 1, 2016.

3 “Quick Facts about Nonprofits,” National Center for Charitable Statistics, <http://nccs.urban.org>, accessed May 15, 2017; Brice S. McKeever, “The Nonprofit Sector in Brief 2015,” Urban Institute, <http://www.urban.org>, accessed May 15, 2017.

4 Julia Halperin, “As a Generation of Directors Reaches Retirement, Fresh Faces Prepare to Take Over US Museums,” The Art Newspaper, <http://www.russellreynolds.com>, June 2, 2015; “Museum Succession in America: Onwards and Upwards,” The Economist, [www.economist.com](http://www.economist.com), May 9, 2015.

5 Government of Canada (2019). <https://www.canada.ca/en/revenue-agency/services/tax/non-profit-organizations.html>

6 Government of Canada (2016). <https://www.canada.ca/en/revenue-agency/services/charities-giving/giving-charity-information-donors/about-registered-charities/what-difference-between-a-registered-charity-a-non-profit-organization.html>

## 2/ The Nature of Entrepreneurship

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SOURCE: [StockSnap](#).

If we look a little more closely at the definition of entrepreneurship, we can identify three characteristics of entrepreneurial activity:<sup>9</sup>

***Innovation.*** Entrepreneurship generally means offering a new product/service, applying a new technique or technology, opening a new market, or developing a new form of organization to produce or enhancing a product.

**Running a business.** A business combines resources to produce goods or services to make a profit.

**Risk taking.** The term risk means that the outcome of the entrepreneurial venture is unknown. Entrepreneurs are always working under uncertainty, and their confidence in the innovation and understanding of the business environment in which they are operating often drives decisions.

It is easy to recognize these characteristics in the entrepreneurial experience of the craft brewers. They certainly had an innovative idea. But was it a good business idea? In a practical sense, a “good” business idea must become something more than just an idea. If, like Collective Arts, you are interested in generating income from your idea, you will probably need to turn it into a product, something that you can market because it satisfies a need. If you want to develop a product, you will need organization to coordinate the resources necessary to make it a reality (a business). Risk enters the equation when you decide to start a business and commit yourself to managing it.

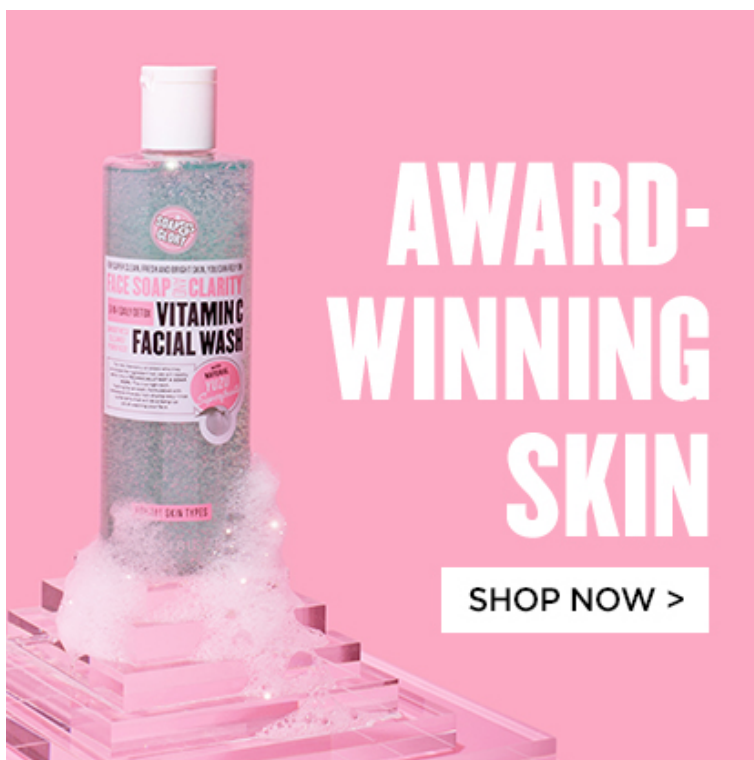


To jumpstart your thinking around entrepreneurship, take this short quiz to align your thinking to Richard Branson, Warren Buffett, Marissa Mayer, or another famous businessperson. *(Please note: This is a general quiz and not scientific. It is just to prompt your thinking, click the bullseye).*

## Going into Business for Yourself

Mark Zuckerberg founded Facebook while a student at Harvard. By age 27 he built up a personal wealth of \$13.5 billion. By age 31, his net worth was \$37.5 billion. Regardless of hurdles his company faced in early 2018, his success as an entrepreneur is solid.

What about you? Do you ever wonder what it would be like to start your own business? You might even turn into a “serial entrepreneur” like Marcia Kilgore.<sup>10</sup> After high school, she moved from Canada to New York City to attend Columbia University. When her financial aid was delayed, Marcia abandoned her plans to attend college and took a job as a personal trainer (a natural occupation for a former bodybuilder and middleweight title holder). Things got boring in the summer when her wealthy clients left the city for the Hamptons. To keep busy, she took a skin care course at a Manhattan cosmetology institute. As a teenager, she was self-conscious about her complexion and wanted to know how to treat it herself. She learned how to give facials and work with natural remedies. She started giving facials to her fitness clients who were thrilled with the results. As demand for her services exploded, she started her first business (Bliss Spa) and picked up celebrity clients, including Madonna, Oprah Winfrey, and Jennifer Lopez. The business went international, and she sold it for more than \$30 million.<sup>11</sup>



The story does not end here; she launched two more companies: Soap and Glory (picture inset), a supplier of affordable beauty products sold at Target, and FitFlops, which sells sandals that tone and tighten your leg muscles as you walk. Oprah loves Kilgore's sandals and plugged them on her show.<sup>12</sup> You cannot get a better endorsement than that. Kilgore never finished college, but when asked if she would follow the same path again, she said, "If I had to decide what to do all over again, I would make the same choices... I found by accident what I'm good at, and I'm glad I did." (SOURCE: SoapandGlory.com)

A few questions to consider if you want to go into business for yourself:

How do I come up with a business idea?

Should I build a business from scratch, buy an existing business, or invest in a franchise?

What steps are involved in developing a business plan?

Where could I find help in getting my business started?

How can I increase the likelihood that I will succeed?

## Why Start Your Own Business?

What sort of characteristics distinguishes those who start businesses from those who do not? Or, more to the point, why do some people follow through on the desire to start their own businesses? The most common reasons for starting a business are:

Be your own boss.

Accommodate a desired lifestyle.

Achieve financial independence.

Enjoy creative freedom.

Use your skills and knowledge.

How can you translate characteristics into potential success? Experts suggest you assess your strengths and weaknesses by asking yourself a few relevant questions.<sup>13</sup>

Am I a self-starter? You will need to develop and follow through on your ideas.

How well do I get along with unique personalities? Strong working relationships with a variety of people are crucial.

How good am I at deciding? Under pressure?

Do I have the physical and emotional stamina? Expect six or seven workdays of about twelve hours every week.

How well do I plan and organize? Poor planning is the culprit in most business failures.

How will my business affect my family? Family members need-to-know what to expect: long hours and, at least initially, a more modest standard of living.

Before we discuss why businesses fail, we should consider why a huge number of business ideas never even make it to the grand opening. One business analyst cites four reservations (or fears) that prevent people from starting businesses:<sup>14</sup>

**Money.** Without cash, you cannot get very far. What to do: line up initial financing early or at least have done enough research to have a plan to raise money.

**Security.** Many people do not want to sacrifice the steady income that comes with the nine-to-five job. Do not give up your day job and run the business part-time or connect with someone to help run your business, a “cofounder”.

**Competition.** many people do not know how to distinguish their business ideas from similar ideas. Figure out how to do something cheaper, faster, or better.

**Lack of ideas.** Some people simply do not know what sort of business they want to get into. What to do: find out what trends are successful. Turn a hobby into

a business. Think about a franchise. Find a solution to something that annoys you, entrepreneurs call this a “pain point” and try to turn it into a business.

If you are still interested in going into business for yourself, try to regard such drawbacks as mere obstacles to be overcome by a combination of planning and creative thinking.

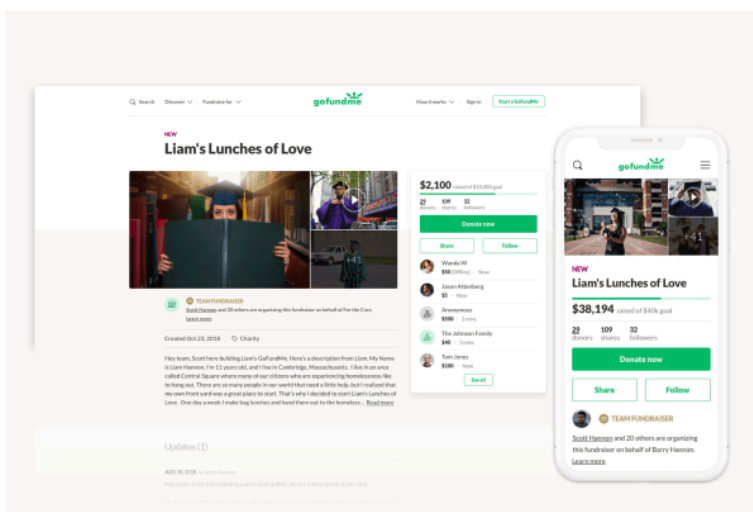
## Sources of Early-Stage Financing

As noted above, many businesses fail, or never get started, because of a lack of funds. But where can an entrepreneur raise money to start a business? Friends and family finance many first-time entrepreneurs, at least in the very early stages. Others may borrow through their personal credit cards, though often, high-interest rates make this approach unattractive or too expensive for the new business to afford.

An entrepreneur with a great idea may win funding through a pitch competition; local municipalities and government agencies understand that economic growth depends on successful new businesses, and so they will often conduct such competitions hoping to attract them.

Crowd funding has become more common to raise capital. An entrepreneur using this approach would typically use a crowd funding platform like [Kickstarter](#) or [GoFundMe](#) to attract investors. The entrepreneur might offer tokens of appreciation for funds or might offer an ownership stake for a substantial enough investment. Take a few moments to peruse Kickstarter or another site and see what types of businesses they propose in your area or trending globally.





SOURCE: [Fast Company](#).

Some entrepreneurs receive funding from angel investors, affluent investors who provide capital to startups for an ownership position in the company. Many angels are successful entrepreneurs themselves and invest not only to make money but also to help other aspiring business owners to succeed.

Venture capital firms also invest in startup companies, although usually at a somewhat later stage and in larger dollar amounts than would be typical of angel investors. Like angels, venture firms also take an ownership position in the company. They usually have a higher expectation of making a return on their money than do angel investors.

## Entrepreneurs versus Small Business Owners

Though most entrepreneurial ventures begin as small businesses, not all small business owners are entrepreneurs. Entrepreneurs are innovators who start companies to create

new or improved products. They strive to meet a need that is not being met, and their goal is to grow the business and eventually expand into other markets.

In contrast, many people either start or buy small businesses for providing an income for themselves and their families. They do not intend to be innovative, nor do they plan to expand significantly. This desire to operate is what is sometimes called a *lifestyle business*.<sup>15</sup> The neighbourhood pizza parlour or beauty shop, the self-employed consultant who works out of the home, and even a local printing company, many of these are typically lifestyle businesses.

## The Importance of Small Business to the Canadian Economy

### What Is a “Small Business”?

To assess the value of small businesses to the Canadian economy, we first need to know what makes up a small business. In 2012, Industry Canada defined **small business** as firms that have fewer than 100 employees. A small business is one that is independently owned and operated, exerting little influence in its industry.

### Why Are Small Businesses Important?

Small business is a force in the Canadian and other economies. The millions of individuals who have started businesses have helped shape the business world as we know it today. Some small business founders like Henry Ford and Thomas Edison have even gained places in history. Others,

including Bill Gates (Microsoft), Mike Lazaridis (Research in Motion), Steve Jobs (Apple Computer), and Larry Page and Sergey Brin (Google), have changed global business today.

Aside from contributions to our general economic wellbeing, founders of small businesses also contribute to growth and vitality in specific areas of economic and socioeconomic development. Small businesses:

- Create jobs.

- Spark innovation.

- Provide opportunities for many people, including women and minorities, to achieve financial success and independence.

In addition, they complement the economic activity of large organizations by providing them with components, services, and distribution of their products. Let us inspect each of these contributions.

## Job Creation

Most Canadian workers first entered the business world working for small businesses. Although the split between those working in small companies and those working in big companies is about even, small firms hire more frequently and fire more regularly than do big companies.<sup>16</sup> Why is this true? At any point in time, lots of small companies start and some expand. These small companies need workers and so hiring takes place. But the survival and expansion rates for small firms is poor, and so, again at any point in time, many small businesses close or contract and workers lose their jobs. Small firms add more jobs over time, increasing the number of workers.

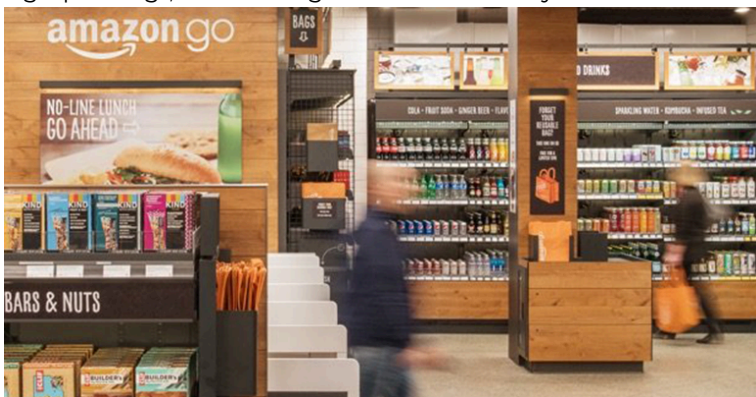
The size of the net increase in the number of workers for any year depends on several factors, with the economy being at the top of the list. A robust economy encourages

individuals to start small businesses and expand existing small companies, which adds to the workforce. A weak economy does just the opposite, it discourages startups and expansions, which decreases the workforce through layoffs.

## Innovation

Given the financial resources available to large businesses, you would expect them to introduce virtually all the new products that hit the market. Yet according to the United States's Small Business Administration (SBA), small companies develop more patents per employee than do larger companies. During a recent four-year period, large firms generated 1.7 patents per hundred employees, while small firms generated an impressive 26.5 patents per employee.<sup>17</sup> Although similar statistics are not available for Canada, our business practices tend to align with our neighbours in the United States.

Over the years, the list of important innovations by small firms has included the airplane, air-conditioning, DNA “fingerprinting”, and overnight national delivery.<sup>18</sup>



SOURCE: [Supermarket News](#).

Small business owners are also particularly adept at finding fresh ways of doing old things. In 1994, a young

computer-science graduate working on Wall Street came up with the novel idea of selling books over the Internet. During the first year of operations, sales at Jeff Bezos' new company, Amazon.com, reached \$500,000. In less than 20 years, annual sales had topped \$107 billion.<sup>19</sup> Not only did his innovative approach to online retailing make Bezos enormously rich, but it also established a viable model for the e-commerce industry. In 2018, Amazon's model is creeping into the physical. Shortly after entering the grocery market by acquiring Whole Foods, they prototype a cashier-less and checkout-less store by using your Amazon account via an application.

Why are small businesses so innovative? They can offer environments that appeal to individuals with the talent to invent new products or improve the process. They encouraged fast decision-making, their research programs are focused, and their compensation structures typically reward top performers.

According to one SBA study, the supportive environments of small firms are roughly 13 times more innovative per employee than the less innovation-friendly environments in which large firms traditionally operate.<sup>20</sup>

The success of small businesses in fostering creativity has not gone unnoticed by big businesses. In fact, many large companies have responded by downsizing to act more like small companies. Some large organizations now have separate work units whose purpose is to spark innovation. Individuals working in these units can focus their attention on creating new products that the company can then develop.

## Opportunities for Women

Small business is the portal through which many people enter the economic mainstream. Business ownership allows individuals to achieve financial success, as well as pride in their accomplishments. While most small businesses are

still owned by white males, the past two decades have seen a substantial increase in the number of businesses owned by women.

Canada's 2018 budget had continued investment in women entrepreneurs. On February 28, 2018, the Financial Post reported:

*"By far, the largest net new impact on Canada's entrepreneurial class is the \$1.65 billion in new financing being made available to women business owners, to be delivered over three years through the Business Development Bank of Canada and Export Development Canada."*



Test your knowledge on women's entrepreneurship at [Virgin.com](https://www.virgin.com).



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## What Industries Are Small Businesses In?

If you want to start a new business, you probably should avoid certain types of businesses. You would have a hard time, for example, setting up a new company to make automobiles or aluminum, because you would have to make tremendous investments in property, plant and equipment, and raise an enormous amount of capital to pay your workforce. These large, up-front investments present barriers to entry.

Fortunately, plenty of opportunities are still available. Many types of businesses require reasonable initial investments, and these are the ones that usually present attractive small business opportunities.

## Advantages and Disadvantages of Business Ownership

Do you want to be a business owner someday? Before deciding, consider the following advantages and disadvantages of business ownership.<sup>21</sup>

### Advantages of Small Business Ownership

Being a business owner can be extremely rewarding. Having the courage to take a risk and start a venture is part of the North American dream. Success brings with it many advantages:



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## Disadvantages of Small Business Ownership

As the little boy said when he got off his first roller-coaster ride, "I like the ups but not the downs!" Here are some risks to starting a small business:



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Despite these and other disadvantages, most small business owners are happy starting a business. A survey conducted by the Wall Street Journal and Cicco and Associates shows that small business owners and top-level corporate executives agree overwhelmingly that small business owners have a more satisfying business experience.

Interestingly, the researchers had fully expected to find that small business owners were happy with their choices; they were, however, surprised at the number of corporate executives who believed that the grass was greener in the world of small business ownership.<sup>22</sup>

## Starting a Business

Starting a business takes talent, determination, hard work, and persistence. It also requires a lot of research and planning. Before starting your business, appraise your strengths and weaknesses and assess your personal goals to determine whether business ownership is for you.<sup>23</sup>



# Questions to Ask Before You Start a Business

If you are interested in starting a business, you need to address these questions:

What, exactly, is my business idea? Is it workable?

What industry do I want to enter?

What will be my competitive advantage?

Do I want to start a new business, buy an existing one, or buy a franchise?

What form of business organization do I want?

After making these decisions, you will be ready to take the most important step in the entire process of starting a business: you must describe your future business as a business plan, a document that identifies the goals of your proposed business and explains how to achieve these goals. Think of a business plan as a blueprint for a proposed company: it shows how you intend to build the company and how you intend to make sure that it is sturdy. You must also take a second crucial step before you start your business, acquiring financing (the money that you will need to start your business).

## The Business Idea

For some people, coming up with a great business idea is a gratifying adventure. For most, however, it is a daunting task. The key to coming up with a business idea is identifying something that customers want; or perhaps filling an unmet need. Your business will probably survive only if its purpose is to satisfy its customers, the ultimate users of its goods or services. In coming up with a business idea, do not ask, “What do we want to sell?” but “What does the customer want to buy?”<sup>24</sup>

To come up with an innovative business idea, you need to be creative. The idea itself can come from various sources. Prior experience accounts for the bulk of new business idea and increases your chances of success. Take Sam Walton, the late founder of Walmart. He began his retailing career at JC Penney and then became a successful franchisor of a Ben Franklin five-and-dime store. In 1962, he came up to open large stores in rural areas, with low costs and heavy discounts. He founded his first Walmart store in 1962, and when he died 30 years later, his family's net worth was \$25 billion.<sup>25</sup>

Industry experience also gave Howard Schultz, a New York executive for a housewares company, his breakthrough idea. In 1981, Schultz noticed that a small customer in Seattle (Starbucks Coffee, Tea, and Spice) ordered more coffeemaker cone filters than Macy's and many other large customers. He flew across the country to find out why. His meeting with the owner-operators of the original Starbucks Coffee Co. resulted in his becoming part-owner of the company. Schultz's vision for the company far surpassed that of its other owners. While they wanted Starbucks to remain small and local, Schultz saw potential for a national business that not only sold world-class-quality coffee beans but also offered customers a European coffee-bar experience. After attempting unsuccessfully to convince his partners to try his experiment, Schultz left Starbucks and started his own chain of coffee bars, which he called Il Giornale (after an Italian newspaper). Two years later, he bought out the original owners and reclaimed the name Starbucks.<sup>26</sup>

## Ownership Options

As we have already seen, you can become a small business owner in one of three ways: 1. starting a new business, 2. buying an existing one, or 3. getting a franchise.

## Starting from Scratch

The most common (and the riskiest) option is starting from scratch. This approach lets you start with a clean slate and allows you to build the business the way you want. You select the goods or services that you are going to offer, secure your location, and hire your employees, and then it is up to you to develop your customer base and build your reputation. This was the path taken by Andres Mason who figured out how to inject hysteria into the process of bargain hunting on the Web. The result is an overnight success story called Groupon.<sup>27</sup> Here is how Groupon (a blend of the words “group” and “coupon”) works: A daily email to over 6.5 million people in over 70 cities across the United States and Canada offering a deeply discounted deal to buy something or to do something in their city. If the person receiving the email likes the deal, he or she commits to buying it. Here is the catch, they cancel the deal if not enough people sign up for it. Groupon makes money by keeping half of the revenue from the deal. The company offering the product or service gets exposure. But stay tuned: the “daily deals website isn’t just unprofitable, it is bleeding hundreds of millions of dollars.”<sup>28</sup> As with all startups cash is always a challenge.

## Buying an Existing Business

If you decide to buy an existing business, some things will be easier because you will already have a proven product, current customers, active suppliers, a known location, and trained employees. The company’s history will make it easier to predict the business’s future success.

There are, of course, a few bumps in this road to business ownership. First, it is hard to determine how much

you should pay for a business. You can easily determine how many things like buildings and equipment are worth, but how much should you pay because the business has steady customers?

In addition, a business, like a used car, might have performance problems that you cannot detect without a test drive (an option, unfortunately, that you do not get when you are buying a business). Perhaps the current owners have disappointed customers; maybe the location is not as good as it used to be. You might inherit employees you would not have hired yourself. Careful study called due diligence is necessary before going down this road.

## Getting a Franchise

You can buy a franchise. A franchisor (the company that sells the franchise) grants the franchisee (the buyer, you) the right to use a brand name and to sell its goods or services. Franchises market products in a variety of industries, including food, retail, hotels, travel, real estate, business services, cleaning services, and even weight loss centres and wedding services. The Figure below lists the top ten franchises according to Entrepreneur Magazine for 2018. Franchises apply to be on the list and assessed using Entrepreneur's [five pillars](#).

Table 2. Top Ten Franchises in 2018 According to Entrepreneur Magazine

- |                  |                  |
|------------------|------------------|
| 1 McDonald's     | 6 Sonic Drive-in |
| 2 7-Eleven Inc.  | 7 Great Clips    |
| 3 Dunkin' Donuts | 8 Taco Bell      |
| 4 The UPS Store  | 9 Hardee's       |
| 5 Re/Max LLC     | 10 Sport Clips   |

In Canada, 1 out of every 14 workers is directly or indirectly employed by the franchise industry and there are about 1,300 franchise brands operating in Canada. Individual investments vary widely, from \$10,000 to millions. KFC franchises, for example, require a total investment of \$1.3 million to \$2.5 million each. This fee includes the cost of the property, equipment, training, startup costs, and the franchise fee, a onetime charge for the right to operate as a KFC outlet. McDonald's is in the same price range (\$1 million to \$2.3 million). SUBWAY sandwich shops offer a more affordable alternative, with expected total investment ranging from \$116,000 to \$263,000. Visit [Canadian Franchising Opportunities](#)<sup>29</sup> to see franchises by level of investment required.

Besides your initial investment, you might pay two other fees monthly, a royalty fee (typically from 3% to 12% of sales) for continued support from the franchisor, and the right to keep using the company's trade name, plus an advertising fee to cover your share of national and regional advertising. The franchisor will expect you to buy your products from them.<sup>30</sup>

But there are disadvantages. The cost of obtaining and running a franchise can be high, and you must play by the franchisor's rules, even when you disagree with them. The franchisor maintains a great deal of control over its franchisees. For example, if you own a fast food franchise, the franchise

agreement will probably dictate the food and beverages you can sell; the methods used to store, prepare, and serve the food; and the prices you will charge. In addition, the agreement will dictate what the premises will look like and how they will maintain. As with any business venture, you need to do your homework before investing in a franchise.

## Why Do Some Businesses Fail?

If you have paid attention to the occupancy of shopping malls over a few years, you have noticed that retailers come and go with surprising frequency. The same thing happens with restaurants, indeed, with all kinds of businesses. Starting a business, small or large, is risky, and though many businesses succeed, a large proportion of them do not. The most recent, official statistics for Canada, from 2013, report the following for the births and deaths of SMEs. Consult the table below or find the equivalent, text information from [Industry Canada](#). Note: These statistics do not deal directly with entrepreneurs, but with small and medium enterprises or SMEs.

As disappointing as these statistics on business survival are, some industries are worse than others. If you want to stay in business for a long time, avoid some of these risky industries. Even though your friends think you make the best pizza in the world, this does not mean you can succeed as a pizza parlour owner. Opening a restaurant or a bar is one of the riskiest ventures (and, therefore, startup funding is hard to get).

You might also want to avoid the transportation industry. Owning a taxi might appear lucrative until you find out what a taxi license costs. It obviously varies by city, but in New York City the price tag is upward of \$400,000. No wonder taxi companies are resisting [Uber](#) and [Lyft](#) with all the energy they can muster. And setting up a shop to sell clothing can be

challenging. Your view of “what is in” may be off, and one poor season can kill your business. The same is true for stores selling communication devices: every mall has one or more cell phone stores so the competition is steep, and business can be very slow.<sup>31</sup>

Businesses fail for many reasons, but many experts agree many failures result from some combination of the following problems:

**Bad business idea.** Like any idea, a business idea can be flawed, either in the conception or in the execution. If you tried selling snow blowers in Hawaii, you could count on little competition, but likely fail.

**Cash problems.** Too many new businesses are under-funded. The owner borrows enough money to set up the business but does not have enough extra cash to operate during the startup phase, when very little money is coming in, but a lot is going out.

**Managerial inexperience or incompetence.** Many new business owners have no experience in running a business; many have limited management skills. Maybe an owner knows how to make or market a product but does not know how to manage people; an owner can't attract and keep talented employees; or an owner has poor leadership skills and isn't willing to plan.

**Lack of customer focus.** A major advantage of a small business is the ability to provide special attention to customers. But some small businesses cannot seize this advantage. Perhaps the owner does not expect customers' needs or keep up with changing markets or the customer-focused practices of competitors.

**Inability to handle growth.** You would think that a sales increase would be a good thing. Often it is, of course, but sometimes it can be a major problem. When a company grows, the owner's role changes. He or she needs to delegate work to others and build a business

structure that can handle the increase in volume. Some owners do not transition and find themselves overwhelmed. Things do not get done, customers become unhappy, and expansion damages the company.

## Some Canadian Considerations

This chapter provided some solid, foundational knowledge on entrepreneurship. But take a few moments to see who might be left behind in the growth of entrepreneurship.



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### *Key Takeaways*

- An entrepreneur is someone who identifies a business opportunity and assumes the risk of creating and running a business to exploit it.
- The three characteristics of entrepreneurial activity are innovating, running a business, and risk taking.
- A small business is independently owned and operated, exerts little influence in its industry, and has fewer than 100 employees.
- An industry is a group of companies that compete with one another to sell similar products.



There are two broad types of industries, or sectors: the goods-producing sector and the service-producing sector.

- Once you decide to start a business, you will need to create a business plan, a document that identifies the goals of your proposed business and explains how it will achieve them.

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# 3/ Industry and Markets

Industry adapted from Fundamentals of Business: Canadian Edition by Pamplin College of Business and Virginia Tech Libraries is licensed under a Creative Commons Attribution-NonCommercial-ShareAlike 4.0 International License, except where otherwise noted.

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SOURCE: [Chevanon Photography](#).

*Learning Objectives*

- Understand and outline how markets are segmented.
- Explain why marketers use some segmentation bases versus others.

## Industries by Sector

Let us define an industry as a group of companies that compete with one another to sell similar products. We will focus on the relationship between a small business and the industry in which it operates, dividing businesses into two broad types of industries, or sectors: the goods-producing sector and the service-producing sector.

- ***Goods-producing sector*** includes all businesses that produce tangible goods, often in the manufacturing, construction, and agriculture sectors.
- ***Service-producing sector*** includes all businesses that provide services but do not make tangible goods. Sectors include retail and wholesale trade, transportation, finance, entertainment, recreation, accommodations, food service, among others.

About 20% of small businesses in the United States are in the goods-producing sector. The remaining 80% are in the service sector.<sup>32</sup> The high concentration of small businesses in the service-producing sector reflects the makeup of the overall United States (U.S.) economy. Over the past 50 years, the service-producing sector has been growing at an impressive rate. In 1960, for example, the goods-producing sector

accounted for 38% of gross domestic product (GDP), the service-producing sector for 62%. By 2015, the balance had shifted dramatically, with the goods-producing sector accounting for only about 21% of GDP.<sup>33</sup>

## Goods-Producing Sector

The largest areas of the goods-producing sector are construction and manufacturing. Skilled workers, often start construction businesses such as electricians, painters, plumbers, and home builders, and they work on local projects. Though manufacturing is primarily the domain of large businesses, there are exceptions. BTIO/Realityworks, for example, is a manufacturing enterprise (components come from Ohio and China, and assembly is in Wisconsin).

## How about making something out of trash?

Daniel Blake never followed his mother's advice at dinner when she told him to eat everything on his plate. When he served as a missionary in Puerto Rico, Aruba, Bonaire, and Curacao after his first year in college, he noticed that the families he stayed with did not either. But they did not throw their uneaten food into the trash. Instead, they put it on a compost pile and used the mulch to nourish their vegetable gardens and fruit trees. While eating at an all-you-can-eat breakfast buffet back home at Brigham Young University, Blake was amazed to see volumes of uneaten food in the trash. This triggered an idea: why not turn the trash into money? Two years later, he was running his company, EcoScraps, collecting 40 tons of food scraps a day from 75 grocers and turning it into

high-quality potting soil that he sells online and to nurseries, profiting almost \$500,000.<sup>34</sup>

## Service-Producing Sector

Many small businesses in this sector are retailers, they buy goods from other firms and sell them to consumers, in stores, by phone, through direct mailings, or over the Internet. In fact, entrepreneurs are turning increasingly to the Internet as a venue for startup ventures. Take Tony Roeder, for example, who had a fascination with the red Radio Flyer wagons that many of today's adults had owned as children. In 1998, he started an online store through Yahoo! to sell red wagons from his home. In three years, he turned his online store into a \$1 million business.<sup>35</sup>

Other small business owners in this sector are wholesalers, they sell products to businesses that buy them for resale or for company use. For instance, a local bakery, for example, is acting as a wholesaler when it sells desserts to a restaurant which then resells them to its customers. Small businesses that buy flowers from a local grower (the manufacturer) and resell them to a retail store is another example of wholesalers.

A high proportion of small businesses in this sector provide professional, business, or personal services. Doctors and dentists are part of the service industry, as are insurance agents, accountants, and lawyers. So are businesses that provide personal services, such as dry cleaning and hairdressing.

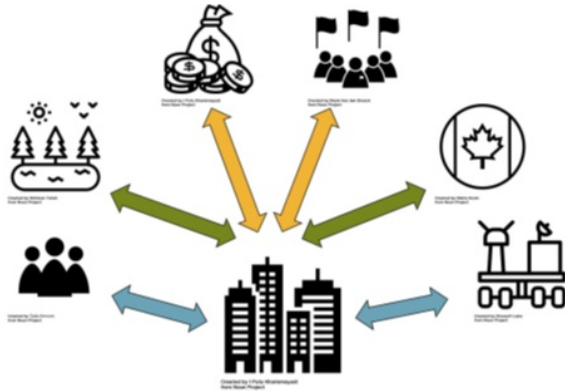
David Marcks, for example, entered the service industry about 14 years ago when he learned that his border collie enjoyed chasing geese at the golf course where he worked. While geese are lovely to look at, they can make a mess of tees, fairways, and greens. That is where Marcks' company, Geese

Police, comes in: Marcks employs specially trained dogs to chase the geese away. He now has 27 trucks, 32 border collies, and five offices. Golf courses account for only about 5% of his business, as his dogs now patrol corporate parks and playgrounds as well.<sup>36</sup>

## External Forces that Influence Business Activities

Apple and other businesses do not operate in a vacuum, several external factors influence them. These include the economy, government, consumer trends, technological developments, public pressure to act as good corporate citizens, and other factors. Collectively, these forces make up the “macro environment,” essentially the big picture world outside over which the business exerts very little if any control.

Figure 1. Impacting Environmental Forces



SOURCE: All icons from the [Noun Project](#). The company surrounded by its environmental forces: demographic, natural, economic, political, cultural, and technological.

“Business and Its Environment” sums up the relationship between a business and the external forces that



influence its activities. One industry that is clearly affected by all these factors is the fast food industry.

Companies such as Taco Bell, McDonald's, Tim Hortons, and others all compete in this industry. Here are a few statements to show the way external factors impact business. For instance, a robust economy means people have more money to eat out. A government agency, the Canadian Food and Drug Inspection Agency at federal, provincial, and municipal levels monitor food standards. Customer trends and preferences influence types of foods (fast food companies now offering healthy menus).

This example shows the large-scale impact of external forces. The Ministry of Health and Long-Term Care's Newsroom on December 30, 2016:

*"Starting January 1, 2017 Ontario will be the first province in Canada to require food service providers with 20 or more locations in the province — such as restaurants, coffee shops, convenience stores, grocery stores, and movie theatres — to include the number of calories for each food and beverage item on their menus, labels, or tags."*

Several decisions made by the industry result from its desire to be a good corporate citizen. Several fast food chains have responded to environmental concerns by eliminating Styrofoam containers.<sup>37</sup>



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Of course, external factors impact all industries, not just the food industry. As people have become more conscious of the environment, they have chosen new technologies, like all-electric cars to replace those that burn fossil fuels. Both established companies, like Nissan with its Nissan Leaf, and brand-new companies like Tesla have entered the market for all-electric vehicles. While the market is still small, they expect

it to grow at a compound annual growth rate of 19.2% between 2013 and 2019.<sup>[38](#)</sup>

## Markets

Sellers can choose to pursue consumer markets, business-to-business (B2B) markets, or both. One obvious way to begin the segmentation process is to segment markets into these two types of groups.

Different factors influence consumers to buy certain things. Many of the same factors can also segment customers. A firm will often use multiple segmentation bases, or criteria to classify buyers, to get a fuller picture of its customers and create actual value for them. Each variable adds a layer of information, like how your professor builds a PowerPoint slide so you can understand the material being presented.

## Types of Segmentation Bases

The table below “Common Ways of Segmenting Buyers” shows some of the different buyer characteristics used to segment markets. Notice that the characteristics fall into one of four segmentation categories: *behavioural*, *demographic*, *geographic*, or *psychographic*. You can get a rough idea of what the categories comprise by looking at them in terms of how marketing professionals might answer the following questions:



SOURCE: [Kaique Rocha](#).

- **Behavioural segmentation.** What benefits do customers want, and how do they use our product?
- **Demographic segmentation.** How do the ages, races, and ethnic backgrounds of our customers affect what they buy?
- **Geographic segmentation.** Where are our customers located, and how can we reach them? What products do they buy based on their locations?
- **Psychographic segmentation.** What do our customers think about and value? How do they live their lives?

Table 1. Common Ways of Segmenting Buyers

<b>Behaviour</b>	<ul style="list-style-type: none"> <li>• Benefits sought from the product</li> <li>• How often the product is used (usage rate)</li> <li>• Usage situation (daily use, holiday use, etc.)</li> <li>• Buyer's status and loyalty to product (nonuser, potential user, first-time users, regular user)</li> </ul>
<b>Demographics</b>	<ul style="list-style-type: none"> <li>• Age/generation</li> <li>• Income</li> <li>• Gender</li> <li>• Family life cycle</li> <li>• Ethnicity</li> <li>• Family size</li> <li>• Occupation</li> <li>• Education</li> <li>• Nationality</li> <li>• Religion</li> <li>• Social class</li> </ul>
<b>Geography</b>	<ul style="list-style-type: none"> <li>• Region (global, national, regional, local)</li> <li>• Size of city or town</li> <li>• Population density</li> <li>• Climate</li> </ul>
<b>Psychographics</b>	<ul style="list-style-type: none"> <li>• Activities</li> <li>• Interests</li> <li>• Opinions</li> <li>• Values</li> <li>• Attitudes</li> <li>• Lifestyles</li> </ul>

## Segmenting by Behaviour

Behavioural segmentation divides people and organization into groups according to how they behave with or act toward products. **Benefits segmentation**, segmenting buyers by the benefits they want from products, is very

common. Take toothpaste, for example. Which benefit is most important to you when you buy a toothpaste: The toothpaste's price, ability to whiten your teeth, fight tooth decay, freshen your breath, or something else? Perhaps it is a combination of two or more benefits. If marketing professionals know what those benefits are, they can then tailor different toothpaste offerings to you (and other people like you). For example, Colgate 2-in-1 Toothpaste & Mouthwash, Whitening Icy Blast aims to people who want the benefits of both fresher breath and whiter teeth.

Video 1. Vintage 1952 Colgate Toothpaste Commercial



*A YouTube element has been excluded from this version of the text. You can view it online here:*

<https://pressbooks.library.upei.ca/startup/?p=455>

[\(Video Link\)](#)

Watch the YouTube video to see a vintage Colgate toothpaste advertisement that describes the product's various

benefits to consumers (On-screen kissing was evidently too racy for the times). Another way in which businesses segment buyers is by their usage rates—that is, how often, if ever, they use certain products. Harrah's, an entertainment, and gaming company, gathers information about the people who gamble at its casinos. High rollers, or people who spend a lot of money known as "VIPs – very important people." VIPs get special treatment, including a personal "host" who looks after their needs during their casino visits. Companies are interested in frequent users because they want to reach people like them.

How people use products is also a basis for segmentation. Avon Skin So Soft was originally a beauty product, but after Avon discovered some people were using it as a mosquito repellant, the company began marketing it for that purpose. Eventually, Avon created a separate product called Skin So Soft Bug Guard, which competes with repellents like Off! Similarly, Glad, the company that makes plastic wrap and bags, found out customers were using its Press'n Seal wrap in ways the company could never have imagined. The personnel in Glad's marketing department subsequently launched a Web site called 1000uses.com that contains both the company's and consumers' use tips. How people use the product is unusual, as evidenced by the following comment posted on the site:

*"I have a hedgehog who likes to run on his wheel a lot. After quite a while of cleaning a gross wheel every morning, I got the tip to use 'Press'n Seal wrap' on his wheel, making clean up much easier! My hedgie can run all he wants, and I do not have to think about the cleanup. Now we're both GLAD!"*

# Segmenting by Demographics

Segmenting buyers by personal characteristics such as age, income, ethnicity, and nationality, education, occupation, religion, social class, and family size, known as **demographic segmentation**. Demographics help segment markets because the information is publicly available in databases around the world. You can get a great deal of demographic information from the U.S. Census Bureau's Web site (<http://www.census.gov>) or Statistics Canada (<https://www.statcan.gc.ca/eng/start>). *The World Factbook* (<http://www.cia.gov/cia/publications/factbook>) contains statistics about countries around the world, including forecasts of demographic trends like population growth expectations.

## Age

At this point in your life, you are probably more likely to buy a car than a funeral plot. Marketing professionals know this. That is why they try to segment consumers by their ages. You are probably familiar with some of the age groups most segmented (see Table below "U.S. Generations and Characteristics") in the United States. Into which category do you fall?

Today's college-age students (Generation Y) compose the largest generation. The baby boomer generation is the second-largest, and over the course of the last 30 years, has been a very attractive market for sellers. Retro brands, old brands, or products that companies "bring back" for a period, aimed at baby boomers during the recent economic downturn. Pepsi Throwback and Mountain Dew Throwback, which are made with cane sugar, like they were "back in the good old days" instead of corn syrup (Schlacter, 2009). Marketing

professionals believe they appealed to baby boomers because they reminded them of better times, times when they did not have to worry about being laid off, about losing their homes, or about their retirement funds and pensions drying up.

Baby boomers are ageing, and the size of the group will eventually decline. The members of Generation Y have a lifetime of buying still ahead of them, which translates to a lot of potential **Customer Lifetime Value** (CLV), the amount a customer will spend on a particular brand over their lifetime, for marketers if they can capture this group of buyers. However, a recent survey found that the latest recession had forced teens to change their spending habits and college plans and that roughly half of older Generation Y reported they had no savings.<sup>39</sup>

Although it is hard to be all things to all people, many companies try to broaden their customer bases by appealing to multiple generations, so they do not lose market share when demographics change. Several companies have introduced lower-cost brands targeting Generation X, who have less spending power than boomers. For example, Williams-Sonoma opened the Elm Street chain, a less-pricey version of the Pottery Barn franchise (Miller, 2009). The video game market is very proud of the fact that along with Generation X and Y, many older Americans still play video games (traditional platforms or online). Products and services in the spa market used to be aimed squarely at adults, but now tweens get facials, pedicures, and other pampering in numbers no one in years past could have imagined.

Video 2. Evian The Baby Bare Necessities





*A YouTube element has been excluded from this version of the text. You can view it online here:*

<https://pressbooks.library.upei.ca/startup/?p=455>

[\(Video Link\)](#) Watch the video to see a fun generational type of advertisement.

U.S. Generations and Characteristics

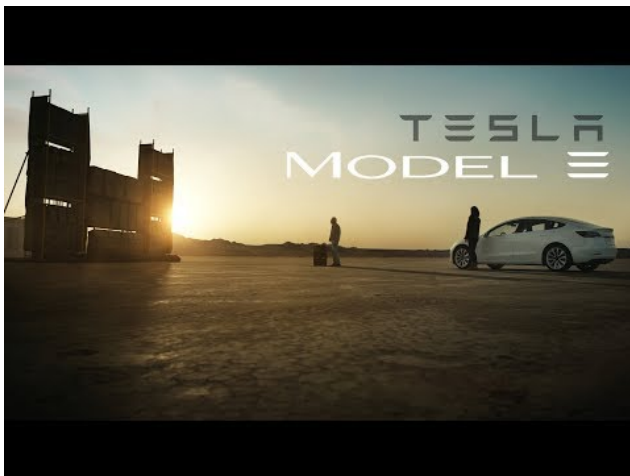
Generation <sup>40</sup>	Known As	Birth Years
Seniors	The Silent Generation Matures Veterans Traditionalists	1945 and Prior
Baby Boomers		1946 – 1964
Generation X	Baby Busters Latchkey Generation Post-Boomers	1965 – 1979
Generation Y	Millennials	1980 – 2000
Generation Z <sup>41</sup>	iGen Centennials	2001 – Today

As early as the 1970s, U.S. automakers found themselves in trouble because of changing demographic trends. Many of the companies' buyers were older Americans inclined to "buy American." These people had not forgotten

that Japan bombed Pearl Harbour during World War II and were not about to buy Japanese vehicles, but younger Americans were. Plus, Japanese cars had developed a better reputation. Despite the challenges U.S. automakers face today, they have taken great pains to cater to the “younger” generation, today's baby boomers do not think of themselves as being old.

Companies must develop new products designed to appeal to Generation X and Y and find alternative ways to reach them. People in these generations not only tend to ignore traditional advertising but also are downright annoyed by it. To market to Scion drivers, who are generally younger, Toyota created Scion Speak, a social networking site where they can communicate, socialize, and view cool new models of the car. Trends now have shifted to more sustainable options, such as Tesla Motors (see video below).

Video 3. TESLA Model 3 Commercial “Feel It”



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*version of the text. You can view it online here:*

<https://pressbooks.library.upei.ca/startup/?p=455>

([Video Link](#)) Tesla Motors.

## Income

Tweens might appear to be a very attractive market when you consider they will buy products for years to come. But would you change your mind if you knew baby boomers account for 50% of all consumer spending in the United States? Americans over 65 now control nearly three-quarters of the net worth of U.S. households; this group spends \$200 billion a year on major “discretionary” (optional) purchases such as luxury cars, alcohol, vacations, and financial products (Reisenwitz, 2007).

Income as a segmentation variable shows a group's buying power and may partially reflect their education levels, occupation, and social classes. Higher education levels usually result in higher paying jobs and greater social status. The makers of upscale products such as Rolex and Lamborghini aim their products at high-income groups. However, a growing number of firms today are aiming their products at lower-income consumers.



SOURCE: [Kelderreisen](#).

The fastest growing product in the financial services sector is prepaid debit cards, most of which are being bought and used by people who do not have bank accounts. Firms find that this group is a large, untapped pool of customers who tend to be more brand loyal than most. If you capture enough of them, you can earn a profit (von Hoffman, 2006). Based on the targeted market, businesses can determine the location and type of stores where they want to sell their products.

Sometimes income is not always indicative of who will buy your product. Companies know that many consumers wish to be in higher income groups and behave like they are already part of them. Mercedes Benz's cheaper line of "C" class vehicles appeals to these consumers.

## Gender

Gender is another way to segment consumers. Men, women, and non-binary people have different needs and shop differently. These groups are often, but not always, segmented

and targeted differently. Marketing professionals do not stop there, though. For example, because women make many of the purchases for their households, market researchers sometimes try to further divide them into subsegments (Men are also often sub-segmental). For women, companies may create segments such as *stay-at-home*, *plan-to-work*, *working*.



SOURCE: [Dani Hart](#).

Besides segmenting by gender, market researchers might couple gender with marital status and other demographic characteristics. For, example, if more women in America than ever before (i.e. 51%) now live without spouses, can you think of any marketing opportunities this might present?

## Family Life Cycle

Family life cycle refers to the stage's families go through over time and how it affects buying behaviour. For example, if you have no children, your demand for pediatric

services (medical care for children) is likely to be slim to none, but if you have children, your demand might be very high because children frequently get sick. You may be part of the target market not only for pediatric services but also for a host of other products, such as diapers, daycare, children's clothing, entertainment services, and educational products. A secondary segment of interested consumers might be grandparents who are likely to spend less on day-to-day childcare items but more on special occasion gifts for children. We segment many markets based on the special events in people's lives. Think about brides (and hopeful brides) and all the products targeted at them, including Web sites and television shows such as *Say Yes to the Dress*, *My Fair Wedding*, *Platinum Weddings*, and *Bridezillas*.

Resorts also segment vacationers depending on where they are in their family life cycles. When you think of family vacations, you probably think of Disney resorts. Some vacation properties, such as Sandals, exclude children from some of their resorts. Perhaps they do so because some studies show that the market segment with greatest financial potential is married couples without children (Hill et al., 1990).



SOURCE: [Asad Photos](#).

Keep in mind that although you might isolate a segment in the marketplace, including one based on family life cycle, you cannot make assumptions about what the people in it will want. Just like people's demographics change, so do their tastes. For example, over the past few decades U.S. families have been getting smaller. Households with a single occupant are more commonplace than ever, but until recently, that has not stopped people from demanding bigger cars (and more of them) as well as larger houses, or what some people jokingly refer to as "McMansions."

The trends toward larger cars and larger houses appear to be reversing. High energy costs, the credit crunch, and concern for the environment are leading people to demand smaller houses. To attract people such as these, D. R. Horton, the nation's leading homebuilder, and other construction firms are now building smaller homes.

## Ethnicity

People's ethnic backgrounds have a big impact on what they buy. The United States is becoming, and will continue to become, more diverse. Hispanic Americans are the largest and the fastest growing minority in the United States. Companies are going to great lengths to court this once overlooked group. In California, the health care provider Kaiser Permanente runs television ads letting members of this segment know they can request Spanish-speaking physicians and that Spanish-speaking nurses, telephone operators, and translators are available at all its clinics (Berkowitz, 2006).





SOURCE: [Andrea Piacquadio](#).

African Americans are the second-largest ethnic group in America. Collectively, they have the most buying power of any ethnic group in America. We know many people of Asian descent to be early adapters of new technology and have above-average incomes. As a result, companies that sell electronic products, such as AT&T, spend more money segmenting and targeting the Asian community.<sup>42</sup> The table below contains information about the number of people in these groups and their buying power.

Table 2. Major U.S. Ethnic Segments and Their Spending

Group	% of U.S. Population
Hispanics	13.7
African Americans	13.0
Asians	5.0

SOURCE: New American Dimensions, LLC.

As you can guess, even within various ethnic groups there are many differences in terms of the goods and services buyers choose. Painting each group with a broad brush would leave you with an incomplete picture of your buyers. For example, although the common ancestral language among the Hispanic segment is Spanish, Hispanics trace their lineages to different countries. Nearly 70% of Hispanics in the United States trace their lineage to Mexico; others trace theirs to Central America, South America, and the Caribbean.

All Asians share the same race. Chinese, Japanese, and Korean immigrants do not share the same language<sup>2</sup>. Both the Asian and Hispanic market segments include new immigrants, people who immigrated to the United States years ago, and native-born Americans. How (language) will you communicate your offerings to these people, and where?

Sub-segmenting the markets might help you. [New American Dimension](#), a multicultural research firm, has further divided the Hispanic market into the following subsegments:

- **Just moved in'rs.** Recent arrivals, Spanish dependent, struggling but optimistic.
- **FOBRs (fashionistas on a budget).** Spanish dominant, traditional, but striving for trendy.
- **Accidental explorers.** Spanish preferred, not in a rush to embrace U.S. culture.
- **The enlightened.** Bilingual, technology savvy, driven, educated, modern.
- **Doubting Tomásés.** Bilingual, independent, skeptical, inactive, shopping uninvolved.
- **Latin flavoured.** English preferred, reconnecting with Hispanic traditions.
- **SYLrs (single, young latinos).** English dominant, free thinkers, multicultural.

You could break down segments to the individual level, which is the goal behind one-to-one marketing. However, doing so would be dreadfully expensive, notes Juan Guillermo Tornoe, a marketing expert who specializes in Hispanic marketing issues. After all, are you really going to develop different products and different marketing campaigns and communications for each group? Probably not, but *“You need to perform your due diligence and understand where most of the people you are trying to reach land on this matrix, modifying your message according to this insight”* (Tornoe, 2008).

## Segmenting by Geography

Suppose your great new product or service idea involves opening a local store. Before you open the store, you will probably want to do some research to determine which geographical areas have the best potential. For instance, if your business is a high-end restaurant, should it be near the local college or country club? If you sell ski equipment, you probably will want to locate your shop somewhere near a mountain range where there is skiing. You might see a snowboard shop in the same area but probably not a surfboard shop. A surfboard shop is likely to be along the coast, but you probably would not find a snowboard shop on the beach.

Geographic segmentation divides the market into areas based on location and explains why the checkout clerks at stores sometimes ask for your zip code. It is also why businesses print codes on coupons that correspond to zip codes. When customers redeem the coupons, the store can find out where its customers are located (or not located). Geocoding is a process that takes data such as this and plots it on a map. Geocoding can help businesses see where prospective customers might cluster and target them with

various ad campaigns, including direct mail. One of the most popular geocoding software programs is PRIZM NE, which is produced by a company called Claritas. PRIZM NE uses zip codes and demographic information to classify the American population into segments. The idea behind PRIZM is that you are where you live and combining both demographic and geographic information is **geodemographics** or neighbourhood geography. Housing areas in different zip codes typically attract certain types of buyers with certain income levels.

The State of Michigan tourism bureau identifies and targets different customer profiles using PRIZM. Michigan's biggest travel segment are Chicagoans in certain zip codes comprising upper-middle-class households with children, or the "kids in cul-de-sacs" group, as Claritas puts it. The bureau could also identify segments significantly different from the Chicago segment, including blue-collar adults in the Cleveland area who vacation without their children. The organization then created significantly different marketing campaigns to appeal to each group.

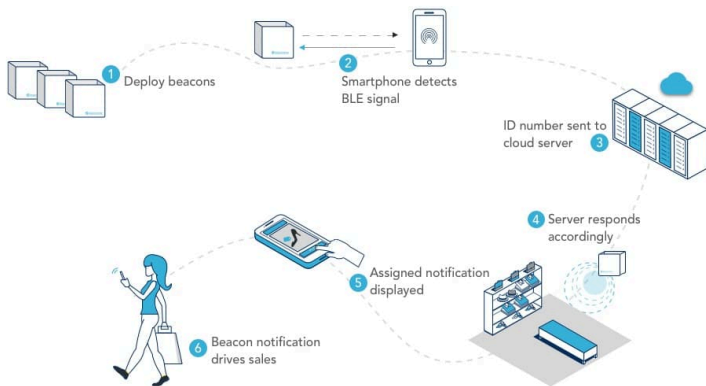
Segmentation also includes city size and population density (the number of people per square mile) For instance, McDonald's generally will not put a store in a town of fewer than 5,000 people. However, this is prime turf for the "DQ" because it does not have to compete with bigger franchises like McDonald's.

**Proximity marketing** is an interesting new technology firms are using to segment and target buyers geographically through geofencing, beacons, NFC tags, and QR codes. For example, geofences are geographical boundaries that recognize a smartphone in range and sends a notification to that phone, which attract customers near their business or competitor locations<sup>43</sup>.

Besides figuring out where to locate stores and advertise to customers in that area, geographic segmentation

helps firms tailor their products. Chances are you cannot find the same heavy winter coat you see at a Walmart in Montana at a Walmart in Florida because of the climate differences between the two places. Market researchers also look at migration patterns to evaluate opportunities. TexMex restaurants are more commonly found in the southwestern United States. However, northern states are now seeing more of them as more people of Hispanic descent move northward.

Figure 2. Proximity Marketing



SOURCE: [beaconstac](https://beaconstac.com).

## Segmenting by Psychographics

If your offering fulfills the needs of a specific demographic group, then the demographic can be an important basis for identifying groups of consumers interested in your product. What if your product crosses several market segments? For example, the group of potential consumers for cereal could be “almost” everyone, although groups of people may have different needs regarding their cereal. Some consumers might be interested in the fibre, some consumers (especially children) may be interested in the prize that comes

in the box, other consumers may be interested in the added vitamins, and still other consumers may be interested in the type of grains. Associating these specific needs with consumers in a particular demographic group could be difficult. Marketing professionals want to know *why* consumers behave the way they do, what is of top priority to them, or how they rank the importance of specific buying criteria. Think about some of your friends who seem a lot like you. Have you ever gone to their homes and been shocked by their lifestyles and how vastly different they are from yours? Why are their families so much different from yours?

**Psychographic segmentation.** Psychographic information is frequently gathered via extensive surveys that ask people about their activities, interests, opinion, attitudes, values, and lifestyles. One of the most well-known psychographic surveys is VALS (which originally stood for “Values, Attitudes, and Lifestyles”) and was developed by a company called SRI International in the late 1980s. SRI asked thousands of Americans the extent to which they agreed or disagreed with questions similar to: *“My idea of fun at a national park would be to stay at an expensive lodge and dress up for dinner”* and *“I could stand to skin a dead animal”* (Donnelly, 2002). Based on their responses to different questions, you divide customers into categories, each characterized by certain buying behaviours.

**Innovators.** Innovators are successful, sophisticated, take-charge people with high self-esteem. Because they have such abundant resources, they exhibit all three primary motivations in varying degrees. They are change leaders and are the most receptive to new ideas and technologies. Innovators are very active consumers, and their purchases reflect cultivated tastes for upscale, niche products and services. Image is important to Innovators, not as evidence of status or power but as an expression of their taste, independence, and personality. Innovators are among the established and emerging leaders

in business and government, yet they continue to seek challenges. Their possessions and recreation reflect a cultivated taste for the finer things in life.

**Thinkers.** Thinkers are motivated by ideals, mature, satisfied, comfortable, and reflective people who value order, knowledge, and responsibility. They tend to be well-educated and actively seek information in the decision-making process. Thinkers are well-informed about world and national events and are alert for opportunities that can broaden their knowledge. These people have a moderate respect for the status quo institutions of authority and social decorum but are open to consider new ideas. Although their incomes allow them many choices, Thinkers are conservative, practical consumers; they look for durability, functionality, and value in the products they buy.

**Achievers.** Motivated by the desire for achievement, Achievers have goal-oriented lifestyles and a deep commitment to career and family. Their social lives reflect this focus and are structured around family, their place of worship, and work. Achievers live conventional lives, are politically conservative, and respect authority and the status quo. They value consensus, predictability, and stability over risk, intimacy, and self-discovery. With many wants and needs, Achievers are active in the consumer marketplace. Image is important to Achievers; they favour established prestige products and services that show success to their peers. Because of their busy lives, they are often interested in a variety of timesaving devices.

**Experiencers.** Experiencers are motivated by self-expression as young, enthusiastic, and impulsive consumers, they quickly become enthusiastic about new possibilities but are equally quick to cool. These people seek variety and excitement, savouring the new, the offbeat, and the risky. Their energy finds an outlet in exercise, sports, outdoor recreation, and social activities. Experiencers are avid consumers and spend a

comparatively high proportion of their income on fashion, entertainment, and socializing. Their purchases reflect the emphasis they place on looking good and having “cool” stuff.

**Believers.** Like Thinkers, Believers are motivated by ideals that are conservative, conventional with concrete beliefs based on traditional, established codes (family, religion, community, nation). Many Believers express moral codes that are deeply rooted and literally interpreted by following established routines, organized around home, family, community, and social or religious organizations they belong. As consumers, they are certain because they choose familiar products, established brands and are generally loyal.

**Strivers.** Strivers are trendy and fun loving because they are driven by achievement with the concern about the opinions/approval of others. Money defines their success as they favour stylish products that emulate the purchases of people with greater material wealth. Many see themselves as having a job rather than a career, and a lack of skills and focus often prevents them from moving ahead. Strivers are active consumers because shopping is both a social activity and an opportunity to show to peers their ability to buy. As consumers, they are as impulsive as their financial circumstance will allow.

**Makers.** Like Experiencers, Makers are motivated by self-expression and experience the world by working on it (building a house, raising children, fixing a car, or canning vegetables). Makers are practical people who have constructive skills and value self-sufficiency. They live within a traditional context of family, practical work, and physical recreation and have little interest in what lies outside that context. Makers suspect new ideas and large institutions such as big business. They are respectful of government authority and organized labour but resentful of government intrusion on individual rights. They are unimpressed by material possessions other than those with a practical or functional purpose because they prefer value to luxury.



**Survivors.** Survivors live narrowly focused lives because they often believe that the world is changing too quickly and are comfortable with the familiar, safety, and security. Their focus on meeting needs rather than fulfilling desires drives Survivors to not show a strong primary motivation, resulting as cautious consumers. They represent a very modest market for most products and services, and loyal to favourite brands (especially if it is discounted).<sup>44</sup>



To find out which category you are in, take a VALS survey at <http://www.sric-bi.com/vals/surveynew.shtml>.

The VALS surveys are adapted and used to study buying behaviour in other countries, too. Note that the basis for both VALS and PRIZM group buyers are their values and lifestyles, but PRIZM also overlays the information with geographic data. As a result, you can gauge what the buying habits of people in certain zip codes are, which can be helpful if you are trying to figure out where to locate stores and retail outlets.

The segmenting techniques we have discussed so far in this section require gathering quantitative information and data. Quantitative information can improve with the *qualitative* information you gather by talking to your customers and getting to know them (this is how Healthy Choice frozen dinners were created.) Consumer insight is a result of using both types of information. You want to answer the following questions:

- Do I see consumers the way they see themselves?
- Am I looking at life from their point of view?

Best Buy asked store employees to develop insight about local consumer groups to create special programs and processes for them. Employees in one location invited a group of retirees to their store to explain how to make the switch to

digital television. The store sold \$350,000 worth of equipment and televisions in just two hours' time. How much did it cost? The total cost included \$99 dollars in labour costs plus coffee and donuts.

Intuit, the company that makes the tax software Quicken, has a "follow me home" program. Teams of engineers from Intuit visit people's homes and spend a couple of hours watching consumers use Quicken. Then they use the insights they gain to improve the next version of Quicken. Contrast this story with that of a competing firm. When a representative of the firm asked if they had ever observed consumers installing or using his company's product, they responded, "I'm not sure I'd want to be around when they were trying to use it" (Nee, 2003). This company is now struggling to stay in business.

## Segmentation in B2B Markets

Many of the same bases used to segment consumer markets are also used to segment B2B markets. For example, Goya Foods is a U.S. food company that sells different ethnic products to grocery stores, depending on the demographic groups the stores serve—Hispanic, Mexican, or Spanish. Likewise, B2B sellers often divide their customers by geographic areas and tailor their products to them accordingly. Segmenting by behaviour is common as well. B2B sellers frequently divide their customers based on their product usage rates. Customers that order many goods and services from a seller often receive special deals and served by salespeople who call on them in person. Smaller customers are more likely to have to rely on a firm's Web site, customer service people, and salespeople who call on them by telephone.

Researchers Matthew Harrison, Paul Hague, and Nick Hague have theorized that there are fewer behavioural and needs-based segments in B2B markets than in business-to-

consumer (B2C) markets for two reasons: (1) business markets have a few hundred customers whereas consumer markets can be hundreds of thousands of customers, and (2) businesses are not as fickle as consumers. Unlike consumers, they are unconcerned about their social standing or influenced by their families and peers. Instead, businesses are anxious with buying products that will ultimately increase their profits. According to Harrison, Hague, and Hague, the behavioural, or needs-based, segments in B2B markets include:

- **Price-focused segment:** small companies that have low profit margins and regard the good or service being sold as not being strategically important to their operations.
- **Quality and brand-focused segment:** firms that want the best possible products and are prepared to pay for them.
- **Service-focused segment:** businesses that demand high-quality products and have top-notch delivery and service requirements.
- **Partnership-focused segment:** firms that seek trust and reliability by their suppliers and see them as strategic partners (Harrison et al., 2010).

B2B sellers, like B2C sellers, are exploring new ways to reach their target markets. Trade shows and direct mail campaigns are two traditional ways of reaching B2B markets. Now, however, firms are finding they can target their B2B customers more cost-effectively via email campaigns, search-engine marketing, and “fan pages” on social networking sites like Facebook. Companies are also creating blogs with innovative content about new products and business trends of interest to their customers. For a fraction of the cost of attending a trade show to exhibit their products, B2B sellers are holding Webcasts and conducting online product demonstrations for potential customers.

### *Key Takeaways*

Segmentation bases are criteria used to classify buyers. The main buyer characteristics used to segment consumer markets are behavioural, demographic, geographic, and psychographic. Behavioural segmentation divides people and organization into groups according to how they behave with or toward products. Segmenting buyers by personal characteristics such as their age, income, ethnicity, family size, and so forth is called demographic segmentation. Geographic segmentation involves segmenting buyers based on where they live. Psychographic segmentation seeks to differentiate buyers based on their activities, interests, opinions, attitudes, values, and lifestyles. Often a firm uses multiple bases to get a fuller picture of its customers and create value for them. Marketing professionals develop consumer insight when they gather both quantitative and qualitative information about their customers. Many of the same bases used to segment consumer markets are used to segment business-to-business (B2B) markets. However, there are generally fewer behavioural-based segments in B2B markets.

## Review Questions

What buyer characteristics do companies look at when they segment markets?

Why do firms often use more than one segmentation base?

What two types of information do market researchers gather to develop consumer insight?

## PESTEL Analysis

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An organization's environment includes factors it can readily affect and factors that lay beyond its influence. The latter set of factors are said to exist within the general environment. Because the general environment often has a substantial influence on an organization's level of success, executives must track trends and events as they develop and try to expect the implications of these trends and events.

**PESTEL analysis**<sup>45</sup> is one important tool that

executives can rely on to organize factors within the general environment and to identify how these factors influence industries and the firms within them. PESTEL reflects the names of the six segments of the general environment: (1) political, (2) economic, (3) social, (4) technological, (5) environmental, and (6) legal. Wise executives carefully examine each of these six segments to identify major opportunities and threats and then adjust their firms' strategies accordingly (see Table below "PESTEL").

Table 3. PESTEL Analysis Table

P	Political	Political factors include elements such as tax policies, changes in trade restrictions and tariffs, and the stability of governments.
E	Economic	Economic factors include elements such as interest rates, inflation rates, gross domestic product, unemployment rates, levels of disposable income, and the general growth or decline of the economy.
S	Social	Social factors include trends in demographics such as population size, age, and ethnic mix, as well as cultural trends such as attitudes toward obesity and consumer activism.
T	Technological	Technological factors include, for example, changes in the rate of new product development, increase in automation, and advancements in service industry delivery.
E	Environmental	Environmental factors include, for example, natural disasters, and weather patterns.
L	Legal	Legal factors include laws involving issues such as employment, health, and safety, discrimination, and antitrust.

## P is for “Political”

The **political segment**<sup>46</sup> centres on the role of governments in shaping business. This segment includes elements such as tax policies, changes in trade restrictions and tariffs, and the stability of governments. Immigration policy is an aspect of the political segment of the general environment that offers important implications for many organizations. The United States, Mexico (and Canada), have argued the best approach to take to illegal immigration. Some hospital executives have noted that illegal immigrants put a strain on the health care system because they can seldom pay for services and hospitals cannot by law turn them away from emergency rooms. Political campaigns provide proposals to support businesses in political campaigns.

Meanwhile, farmers argue that a tightening of immigration policy would be harmful because farmers rely heavily on cheap labour provided by illegal immigrants. If farmers were forced to employ only legal workers, this would substantially increase the cost of vegetables. Restaurant chains such as Subway would then pay higher prices for lettuce, tomatoes, and other perishables. Subway would then have to decide whether to absorb these costs or pass them along to customers by charging more for subs. Overall, any changes in immigration policy will have implications for hospitals, farmers, restaurants, and many other organizations.



SOURCE: [Quang](#).

## E is for “Economic”

The **economic segment**<sup>47</sup> centres on the economic conditions within which organizations operate. It includes elements such as interest rates, inflation rates, gross domestic product, unemployment rates, levels of disposable income, and the general growth or decline of the economy. The economic crisis of the late 2000s has had a tremendous negative effect on a vast array of organizations. Rising unemployment discouraged consumers from purchasing expensive, nonessential goods such as automobiles and television sets. Bank failures during the economic crisis led to a dramatic tightening of credit markets. This dealt a tremendous blow to home builders, for example, who saw demand for new houses plummet because mortgages were extremely difficult to get.

Some businesses, however, prospered during the crisis. Retailers that offer deep discounts, such as Dollarama and Walmart, enjoyed an increase in their customer base as



consumers sought to economize. Similarly, restaurants such as Subway that charge relatively low prices gained customers, while high-end restaurants such as The Keg worked hard to keep their clientele.

## S is for “Social”

A generation ago, ketchup was an essential element of every American pantry and salsa was a relatively unknown product. Today, however, food manufacturers sell more salsa than ketchup in the United States. This change reflects the **social segment**<sup>48</sup> of the general environment. Social factors include trends in demographics such as population size, age, and ethnic mix, as well as cultural trends such as attitudes toward obesity and consumer activism. The exploding popularity of salsa reflects the increasing number of Latinos in the United States over time, as well as the growing acceptance of Latino food by other ethnic groups.

Sometimes changes in the social segment arise from unexpected sources. Before World War II, the American workforce was overwhelmingly male. When millions of men went to Europe and Asia to fight in the war, however, organizations had no choice but to rely heavily on female employees. The attitudes of many executives toward women were appalling. Consider, for example, some of the advice provided to male supervisors of female workers in the July 1943 issue of *Transportation Magazine*:

- Older women who have never contacted the public have a hard time adapting themselves to be cantankerous and fussy. It is always well to impress upon older women the importance of friendliness and courtesy.
- General experience shows that “husky” girls, those who are just a little on the heavy side, are more even tempered and

efficient than their underweight sisters.

- Give every girl enough rest periods during the day. You must make some allowances for feminine psychology. A girl has more confidence and is more efficient if she can keep her hair tidied, apply fresh lipstick, and wash her hands several times a day.

The tremendous contributions of female workers during the war contradicted these awful stereotypes. The key role for women who assembled airplanes, ships, and other war materials was to support the military, of course, but their efforts also changed a lot of male executives' minds about what females could accomplish within organizations if provided with opportunities. Inequities in the workplace still exist today, but modern attitudes among men toward women in the workplace are much more enlightened than in 1943.

Beyond being a positive social change, the widespread acceptance of women into the workforce has created important opportunities for certain organizations. Retailers such as Talbot's and Dillard's sell business attire to women. Subway and other restaurants benefit when the scarceness of time lead dual-income families to purchase takeout meals rather than cook.



SOURCE: [Ketut Subiyanto](#).

## T is for “Technological”

The **technological segment**<sup>49</sup> centres on improvements in products and services that are provided by science. Relevant factors include, for example, changes in the rate of new product development, increases in automation, and advancements in service industry delivery. One key feature of the modern era is the ever-increasing pace of technological innovation. In 1965, Intel cofounder Gordon E. Moore offered an idea that is now known as Moore’s law. Moore’s law suggests that performing microcircuit technology roughly doubles every two years. This law has been very accurate in the decades since its offering.

One implication of Moore’s law is that over time electronic devices can become smaller but also more powerful. This creates important opportunities and threats in a variety of settings. For example, just a decade ago, digital cameras were relatively large, and they produced mediocre images. With

each passing year, however, digital cameras have become smaller, lighter, and better. Today, digital cameras are minicomputers, and electronics firms such as Panasonic have been able to establish sound positions in the market. Meanwhile, Kodak has abandoned products that had been successful for decades. In 2005, the firm announced it would stop producing black and white photographic paper and in 2009, Kodachrome colour film phased out.



SOURCE: [Lisa](#).

Successful technologies are also being embraced at a much faster rate than in earlier generations. The Internet reached 50 million users in only four years. In contrast, television reached the same number of users in 13 years while it took radio 38 years. This trend creates great opportunities for organizations that depend on emerging technologies. Writers of applications for Apple's iPad and other tablet devices, for example, can target a fast-growing population of users. Organizations that are technologically dependent being displaced must know consumers could abandon them rapidly. As more and more Internet users rely on Wi-Fi service (i.e. demand for cable modems may plummet).

Although the influence of the technological segment on technology-based companies such as Panasonic and Apple are clear, technological trends, and events help to shape low-tech businesses too. In 2009, Subway started a service called Subway Now. This service allows customers to place their orders in advance using text messages and avoid standing in line at the store. Offering customers this service, Subway is also responding to a trend in the general environment's social segment: the need to save time in today's fast-paced society.

## E is for “Environmental”

The **environmental segment**<sup>50</sup> involves the physical conditions within which organizations operate. It includes factors such as natural disasters, pollution levels, and weather patterns. The threat of pollution, for example, has forced municipalities to treat water supplies with chemicals. These chemicals increase the safety of the water but detract from its taste. This has created opportunities for businesses that provide better-tasting water, where many consumers purchase bottled water. According to the Agriculture and Agri-Foods Canada, bottled water amounts to 10.9% of the market share of Canadian non-alcoholic beverage market.



SOURCE: [Mali Maeder](#).

Bottled water producers have benefited from the general environment but also are threatened by it. Some estimates are that 80% of plastic bottles end up in landfills. This has led some socially conscious consumers to become hostile to bottled water. Meanwhile, water filtration systems offered by Brita and other companies are a cheaper way to get clean and tasty water. Such systems also hold considerable appeal for individuals who feel the need to cut personal expenses because of economic conditions. In sum, bottled water producers have been provided opportunities by the environmental segment of the general environment (specifically, the spread of poor-tasting water to combat pollution) but face threats from the social segment (the social conscience of some consumers) and the economic segment (the financial concerns of other consumers).

## L is for “Legal”

The **legal segment**<sup>51</sup> centres on how the courts

influence business activity. Examples of important legal factors include employment laws, health, and safety regulations, discrimination laws, and antitrust laws. **Intellectual property rights**<sup>52</sup> are a daunting aspect of the legal segment for many organizations. When a studio such as Pixar produces a movie, a software firm such as Adobe revises a program, or a video game company such as Activision devises a new game, these firms are creating intellectual property. Such firms attempt to make profits by selling copies of their movies, programs, and games to individuals. Piracy of intellectual property (a process wherein illegal copies are made and sold by others) poses a serious threat to such profits. Law enforcement agencies and courts in many countries provide organizations with the legal mechanisms to protect their intellectual property from piracy.

#### *Key Takeaways*

To transform an avocado into guacamole, a chef may choose to use a mortar and pestle. A mortar is a mashing device that is shaped like a baseball bat, while a pestle is a sturdy bowl within which the mashing takes place. Similarly, PESTEL reflects the general environment factors—political, economic, social, technological, environmental, and legal—that can crush an organization. Most times, executives can prevent such outcomes by performing a PESTEL analysis to diagnose where in the general environment important opportunities and threats arise.

## Exercises

- What does each letter of PESTEL mean?
- Using a recent news article, identify a trend that has a positive and negative implication for a particular industry.
- Can you identify a general environment trend that has positive implications for nursing homes but negative implications for diaper makers?
- Are all six elements of PESTEL important to every organization?
- What is a key trend for each letter of PESTEL and one industry or firm that would be affected by that trend?

## Footnotes

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[45](#) **PESTEL analysis:** The examination of political, economic,

social, technological, environmental, and legal factors and their implications for an organization.

[46](#) **Political segment:** The portion of the general environment that involves governments.

[47](#) **Economic segment:** The portion of the general environment that involves economic and financial conditions.

[48](#) **Social segment:** The portion of the general environment that involves demographics and cultural trends.

[49](#) **Technological segment:** The portion of the general environment that involves scientific advances.

[50](#) **Environmental segment:** The portion of the general environment that involves the natural environment.

[51](#) **Legal segment:** The portion of the general environment that involves the law and courts.

[52](#) **Intellectual property rights:** The ability of an organization to protect intangible goods such as movies, software, and video games from piracy.

# 4/ Markets and Strategic Planning

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SOURCE: [Lex Photography](#).

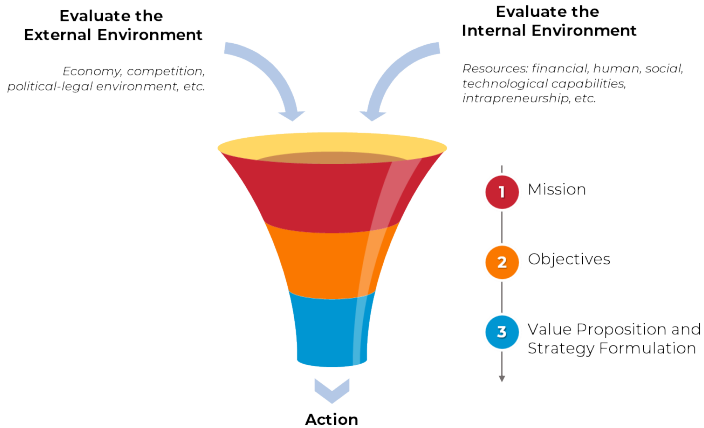
*Learning Objectives*

- Explain how a mission statement helps a company with its strategic planning.
- Describe how a firm analyzes its internal environment.
- Describe the external environment a firm may face and how it is analyzed.

## The Strategic Planning Process

Strategic planning is a process that helps an organization allocate its resources to capitalize on opportunities in the marketplace. Typically, it is a long-term process. The strategic planning process includes conducting a situation analysis and developing the organization's mission statement, objectives, value proposition, and strategies. The Strategic Planning Process figure below shows the components of the strategic planning process.

Figure 1. The Strategic Planning Process



## Conducting a Situation Analysis

As part of the strategic planning process, a situation analysis must be conducted before a company can decide on specific actions. A situation analysis involves analyzing both the external (macro and micro factors outside the organization) and the internal (company) environments. The Strategic Planning Process and the Elements of a SWOT Analysis show examples of internal and external factors affecting businesses. The firm's internal environment, such as its financial resources, technological resources, and the capabilities of its personnel and their performance must be examined. It is also critical to examine the external macro and microenvironments the firm faces, such as the economy and its competitors.

The external environment significantly affects the decisions a firm makes, and thus must be continuously evaluated. For example, during the economic downturn in 2008–2009, businesses found many competitors cut the prices of their products drastically. Other companies reduced package sizes or the amount of product in packages. Firms also offered customers incentives (free shipping, gift cards with

purchase, rebates, etc.) to purchase their goods and services online, which allowed businesses to cut back on the personnel needed to staff their brick-and-mortar stores. While a business cannot control things such as the economy, changes in demographic trends, or what competitors do, it must decide what actions to take to remain competitive (actions that depend in part on their internal environment).

## Conducting a SWOT Analysis

Based on the situation analysis, organizations analyze their Strengths, Weaknesses, Opportunities, and Threats, or conduct what is called a SWOT analysis. Strengths and weaknesses are internal factors and are somewhat controllable. For example, an organization's strengths might include its brand name, efficient distribution network, reputation for great service, and strong financial position. A firm's weaknesses might include lack of awareness of its products in the marketplace, a lack of human resources talent, and a poor location. Opportunities and threats are factors that are external to the firm and uncontrollable. Opportunities might entail the international demand for the type of products the firm makes, few competitors, and favourable social trends such as people living longer. Threats might include a poor economy, high-interest rates that increase a firm's borrowing costs, and an aging population that makes it hard for the business to find workers.

You can conduct a SWOT analysis of yourself to help determine your competitive advantage. Perhaps your strengths include strong leadership abilities and communication skills, whereas your weaknesses include a lack of organization. Opportunities for you might exist in specific careers and industries; however, the economy and other people competing for the same position might be threats. A

factor that is a strength for one person (say, strong accounting skills) might be a weakness for another person (poor accounting skills). The same is true for businesses. See Figure below for an illustration of some factors examined in a SWOT analysis.

The easiest way to determine if a factor is external or internal is to take away the company, organization, or individual and see if the factor still exists. Internal factors such as strengths and weaknesses are specific to a company or individual, whereas external factors such as opportunities and threats affect multiple individuals and organizations in the marketplace. For example, if you are doing a situation analysis on PepsiCo and are looking at the weak economy, take PepsiCo out of the picture and see what factors remain. If the factor (the weak economy) is still there, it is an external factor. Even if PepsiCo had not been around in 2008–2009, the weak economy reduced consumer spending and affected a lot of companies.

Table 1. Elements of a SWOT(P) Analysis

	Strengths	
Your Business		
Competitor 1		
Competitor 2		
Competitor 3		

## Assessing the Internal Environment

As we have showed, when an organization evaluates which factors are its strengths and weaknesses, it is assessing its internal environment. Once companies determine their strengths, they can use those strengths to capitalize on opportunities and develop their competitive advantage. For example, strengths for PepsiCo are what are called “mega” brands, or brands that individually generate over \$1 billion in sales. These brands are also designed to contribute to PepsiCo’s environmental and social responsibilities.

PepsiCo’s brand awareness, profitability, and strong presence in global markets are also strengths. Especially in foreign markets, the loyalty of a firm’s employees can be a major strength, which can provide it with a competitive advantage. Loyal and knowledgeable employees are easier to train and tend to develop better relationships with customers. This helps organizations pursue more opportunities.

Although the brand awareness for PepsiCo’s products is strong, smaller companies often struggle with weaknesses such as low brand awareness, low financial reserves, and poor locations. When organizations assess their internal environments, they must look at factors such as performance and costs and brand awareness and location. Managers need to examine both the past and current strategies of their firms and determine what strategies succeeded and which ones failed. This helps a company plan its future actions and improves the odds they will be successful. For example, a company might look at packaging that worked very well for a product and use the same type of packaging for new products. Firms may also look at customers’ reactions to changes in products, including packaging, to see what works and does not work. When PepsiCo changed the packaging of major brands in 2008, customers had mixed responses. Tropicana switched from the familiar orange with the straw in it to a new package



and customers did not like it. As a result, Tropicana changed back to their familiar orange with a straw after spending \$35 million for the new package design.

Video 1. Tropicana Advertisement



*A YouTube element has been excluded from this version of the text. You can view it online here:*

<https://pressbooks.library.upei.ca/startup/?p=469>

([Video Link](#))

Individuals are also wise to look at the strategies they have tried in the past to see which ones failed and which ones succeeded. Have you ever done poorly on an exam? Was it the instructor's fault, the strategy you used to study, or did you decide not to study? See which strategies work best for you and perhaps try the same type of strategies for future exams. If a strategy did not work, see what went wrong and change it. Doing so is like what organizations do when they analyze their internal environments.

## Video 2. Tropicana Rebranding Woes



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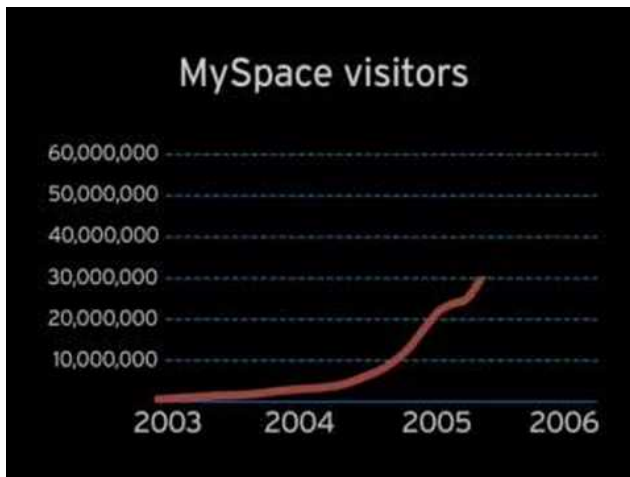
## Assessing the External Environment

Analyzing the external environment involves tracking conditions in the macro and micro marketplace that, although uncontrollable, affect the way an organization does business. The macro environment includes economic factors, demographic trends, cultural and social trends, political and legal regulations, technological changes, and the price and availability of natural resources. Each factor in the macro environment is discussed separately in the next section. The

microenvironment includes competition, suppliers, marketing intermediaries (retailers, wholesalers), the public, the company, and customers.

When firms globalize, analyzing the environment becomes more complex because they must examine the external environment in each country in which they do business. Regulations, competitors, technological development, and the economy may be different in each country and will affect how firms do business. To see how factors in the external environment such as technology may change education and lives of people around the world, watch “Did You Know?” (4.0) focused on changing media and technology and showed how information may change the world and the way people communicate and conduct business.

Video 3. Globalization Factors



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version of the text. You can view it online here:

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([Video Link](#))

Video 4. Did You Know 4.0?



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<https://pressbooks.library.upei.ca/startup/?p=469>

([Video Link](#)) To see how fast things change and the impact of technology and social media, visit “Did You Know 4.0?”

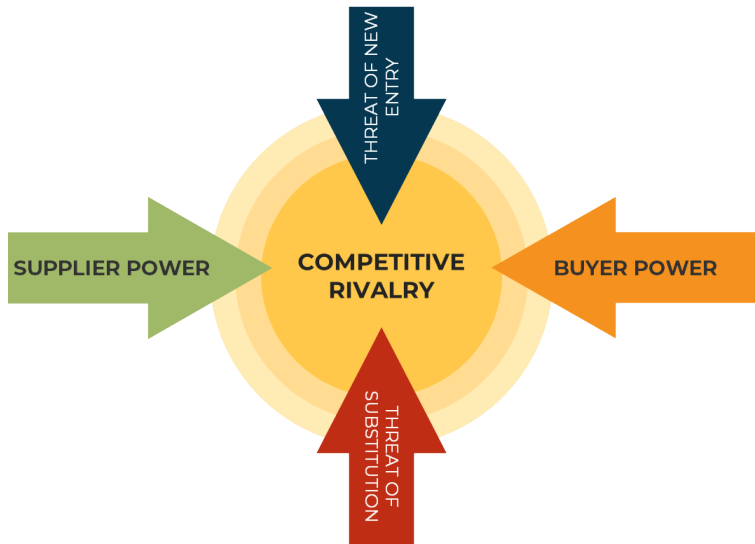
Although the external environment affects all organizations, companies must focus on factors that are relevant for their operations. For example, government regulations on food packaging will affect PepsiCo but not

Goodyear. Similarly, students getting a business degree do not need to focus on job opportunities for registered nurses.

# The Competitive Environment

All organizations must consider their competition, whether it is direct or indirect competition vying for the consumer’s dollar. Both non-profit and for-profit organizations compete for customers’ resources. Coke and Pepsi are direct competitors in the soft drink industry, Hilton, and Sheraton are competitors in the hospitality industry, and organizations such as United Way and the American Cancer Society compete for resources in the non-profit sector. However, hotels must also consider other options that people have when selecting a place to stay, such as hostels, dorms, bed and breakfasts, or rental homes.

Figure 2. Five Forces Model



A group of competitors that provide similar products or services form an industry. Michael Porter, a professor at

Harvard University and a leading authority on competitive strategy, developed an approach for analyzing industries. Called the five forces model (Porter, 1980) and shown in the Figure above, the framework helps organizations understand their current competitors as well as organizations that could become competitors in the future. Firms can find the best way to defend their position in the industry.

## Competitive Analysis

When a firm conducts a competitive analysis, they tend to focus on direct competitors and try to determine a firm's strengths and weaknesses, its image, and its resources. Doing so helps the firm figure out how much money a competitor may spend on things such as research, new product development, promotion, and new locations. Competitive analysis involves looking at any information (annual reports, financial statements, news stories, observation details on visits, etc.) on competitors. Another means of collecting competitive information uses mystery shoppers, or people who act like customers. Mystery shoppers might visit competitors to learn about their customer service and their products. Imagine going to a competitor's restaurant and studying the menu and the prices and watching customers to see what items are popular and then changing your menu to better compete. Competitors battle for the customer's dollar and they must know what other firms are doing. Individuals and teams also compete for jobs, titles, and prizes and must figure out the competitors' weaknesses and plans to take advantage of their strengths and have a better chance of winning.

According to Porter, besides their direct competitors (competitive rivals), organizations must consider the strength and impact the following could have (Porter, 1980):

- Substitute products
- Potential entrants (new competitors) in the marketplace
- The bargaining power of suppliers
- The bargaining power of buyers

When any of these factors change, companies may have to respond by changing their strategies. For example, because buyers are consuming fewer soft drinks these days, companies such as Coke and Pepsi have had to develop new substitute offerings such as vitamin water and sports drinks. However, other companies such as Dannon or Nestlé may also be potential entrants in the flavoured water market. When you select a hamburger fast food chain, you also had the option of substitutes such as getting food at the grocery or going to a pizza place. When computers entered the market, they were a substitute for typewriters.

The world is becoming “smaller” and a more of a global marketplace. Companies everywhere find that no matter what they make, many firms around the world are producing the same “widget” or a similar offering (substitute) and are eager to compete with them. Employees are in the same position. The Internet has made it easier than ever for customers to find products and services and for workers to find the best jobs available, even if they are abroad. Companies are also acquiring foreign firms. These factors all influence the strategic decisions companies make.



SOURCE: [Quangpraha](#).

## The Political and Legal Environment

All organizations must comply with government regulations and understand the political and legal environments in which they do business. Different government agencies enforce the many regulations that have protected both consumers and businesses. For example, the Sherman Act (1890) prohibits U.S. firms from restraining trade by creating monopolies and cartels. The regulations related to the act are enforced by the Federal Trade Commission (FTC), which also regulates deceptive advertising. The U.S. Food and Drug Administration (FDA) regulates the labelling of consumable products, such as food and medicine. One organization that has been extremely busy is the Consumer Product Safety Commission, the group that sets safety standards for consumer products. Unsafe baby formula and toys with lead paint caused a big scare among consumers in 2008 and 2009.



The U.S. Food and Drug Administration prohibits companies from using unacceptable levels of lead in toys and other household objects, such as utensils and furniture. Mattel voluntarily recalled Sarge cars made in mid-2000. [U.S. Consumer Product Safety Commission](#) – public domain.



SOURCE: [Pezibear](#).

As we have explained, when organizations conduct business in multiple markets, they must understand that regulations vary across countries and across states. Many states and countries have different laws that affect strategy. For example, suppose you are opening a new factory because you cannot keep up with the demand for your products. If you are considering opening the factory in France (perhaps because the demand in Europe for your product is strong), you need to know that it is illegal for employees in that country to work over 35 hours per week.

## The Economic Environment

The economy has a major impact on spending by both

consumers and businesses, which affects the goals and strategies of organizations. Economic factors include variables such as inflation, unemployment, interest rates, and whether the economy is in a growth period or a recession. Inflation occurs when the cost of living continues to rise, eroding the purchasing power of money. When this happens, you and other consumers and businesses need more money to purchase goods and services. Interest rates often rise when inflation rises. Recessions can also occur when inflation rises because higher prices sometimes cause low or negative growth in the economy.

During a recessionary period, it is possible for both high-end and low-end products to sell well. Consumers who can afford luxury goods may continue to buy them, while consumers with lower incomes tend to become more value conscious. Other goods and services, such as products sold in traditional department stores, may suffer. Faced with a severe economic downturn, even the sales of luxury goods can suffer. The economic downturn that began in 2008 affected consumers and businesses at all levels worldwide. Consumers reduced their spending, holiday sales dropped, financial institutions went bankrupt, the mortgage industry collapsed, and the “Big Three” U.S. auto manufacturers (Ford, Chrysler, and General Motors) asked for emergency loans.

The demographic and social and cultural environments—including social trends, such as people’s attitudes toward fitness and nutrition; demographic characteristics, such as people’s age, income, marital status, education, and occupation; and culture, which relates to people’s beliefs and values—are constantly changing in the global marketplace. Fitness, nutrition, and health trends affect the product offerings of many firms. For example, PepsiCo produces vitamin water and sports drinks. More women are working, which has led to a rise in the demand for services such as house cleaning and daycare. U.S. baby boomers are

reaching retirement age, sending their children to college, and trying to care for their elderly parents all at the same time. Firms are responding to the time constraints their buyers face by creating products that are more convenient, such as frozen meals and nutritious snacks.

The composition of the population is also constantly changing. Hispanics are the fastest growing minority in the United States. Consumers in this group and other diverse groups prefer different products and brands. In many cities, stores cater specifically to Hispanic customers.

## Technology

The technology available in the world is changing the way people communicate and the way firms do business. Everyone is affected by technological changes. Self-scanners and video displays at stores, ATMs, the Internet, and mobile phones are a few examples of how technology is affecting businesses and consumers. Many consumers get information, read the news, use text messaging, and shop online. As a result, marketers have allocated more of their promotion budgets to online ads and mobile marketing and not just to traditional print media such as newspapers and magazines. Applications for telephones and electronic devices are changing the way people get information and shop, allowing customers to comparison shop without having to visit multiple stores. As you saw in “Did You Know 4.0?” technology and social media are changing people’s lives. Many young people may rely more on electronic books, magazines, and newspapers and depend on mobile devices for most of their information needs. Organizations must adapt to new technologies to succeed.



SOURCE: [Panumas](#).

Technology changes the way we do business. Banking on a cell phone adds convenience for customers. Bar codes on merchandise speed the checkout process.

## Natural Resources

Natural resources are scarce commodities, and consumers are realizing this. Today, many firms are doing more to engage in “sustainable” practices that help protect the environment and conserve natural resources. Green marketing involves marketing environmentally safe products and services in a way that is good for the environment. Water shortages often occur in the summer months, so many restaurants now only serve patrons water upon request. Hotels voluntarily conserve water by not washing guests’ sheets and towels every day unless they request it. Reusing packages (refillable containers) and reducing the amount of packaging, paper, energy, and water in the production of goods and services are becoming key considerations for many organizations, whether

they sell their products to other businesses or final users (consumers). Construction companies are using more energy efficient materials and often must comply with green building solutions. Green marketing not only helps the environment but also saves the company, and ultimately the consumer, money. Sustainability, ethics (doing the right things), and social responsibility (helping society, communities, and other people) influence an organization's planning process and the strategies they implement.

Although environmental conditions change and must be monitored continuously, the situation analysis is a critical input to organizations or an individual's strategic plan.



SOURCE: [Pixabay](https://www.pixabay.com/).

## The Mission Statement

The firm's mission statement states the purpose of the organization and why it exists. Both profit and non-profit organizations have mission statements, which they often publicize. Sometimes SBUs develop separate mission statements. For example, PepsiCo Americas Beverages, PepsiCo Americas Foods, and PepsiCo International might each develop a different mission statement.



SOURCE: [Tim Mossholder](#).

## PepsiCo's Mission Statement

*"Our mission is to be the world's premier consumer products company focused on convenient foods and beverages. We seek to produce financial rewards to investors as we provide opportunities for growth and enrichment to our employees, our business partners, and the communities in which we operate. And in everything we do, we strive for honesty, fairness, and integrity."*<sup>53</sup>



SOURCE: [Extremis](#).

## *The United Way's Mission Statement*

*"To improve lives by mobilizing the caring power of communities. <sup>54</sup>"*

### *Key Takeaways*

A firm must analyze factors in the external and internal environments it faces throughout the strategic planning process. These factors are inputs to the planning process. As they change, the company must be prepared to adjust its plans. Different factors are relevant for different companies. Once a company has

analyzed its internal and external environments, managers can decide which strategies are best, given the firm's mission statement.

## Review Questions

What factors in the external environment are affecting the “Big Three” U.S. automobile manufacturers?

What are some examples of Walmart's strengths?

Suppose you work for a major hotel chain. Using Porter's five forces model, explain what you need to consider regarding each force.

## Footnotes

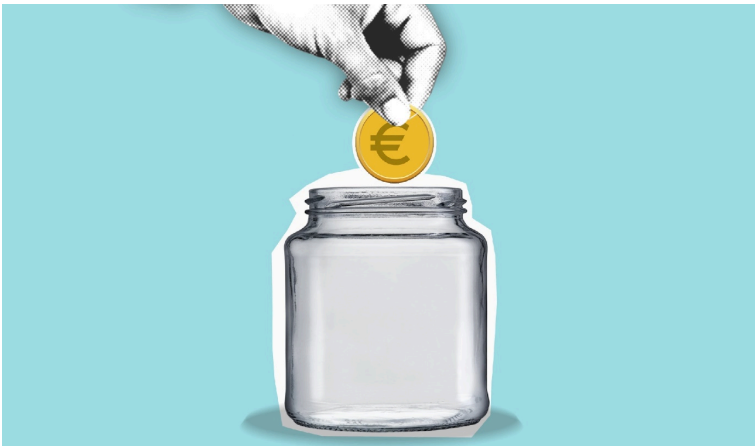
<sup>53</sup> PepsiCo, Inc., “Our Mission and Vision,” <http://www.pepsico.com/Company/Our-Mission-and-Vision.html> (accessed December 7, 2009).

<sup>54</sup> United Way Worldwide, “Mission and Vision,” <http://www.liveunited.org/about/missvis.cfm> (accessed December 7, 2009).



# 5/ Value Propositions

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SOURCE: [Gabby K.](#)

## *Learning Objectives*

- Explain what a value proposition is.
- Understand why a company may develop unique value propositions for different target markets.

# Value Propositions

Individual buyers and organizational buyers both evaluate products and services to see if they provide desired benefits. For example, when you are exploring your vacation options, know the benefits of each destination and the value you get by going to each place. Before you (or a firm) can develop a strategy or create a strategic plan, you first must develop a value proposition. A value proposition is a 30-second “elevator speech” stating the specific benefits a product or service offering provides a buyer. It shows why the product or service is superior to competing offers. The value proposition answers the questions, “Why should I buy from you or why should I hire you?” The value proposition becomes critical in shaping strategy.

The following is an example of a value proposition developed by a sales consulting firm: “Our clients grow their business, large or small, typically by a minimum of 30% to 50% over the previous year. They accomplish this without working 80-hour weeks and sacrificing their personal lives” (Lake, 2009).

Note that although a value proposition will hopefully lead to profits for a firm, when the firm presents its value proposition to its customers, it does not mention its own profits. The goal is to focus on the external market or what customers want. For instance, Beaches, an all-inclusive chain of resorts for families, must explain what its value proposition is to customers. Why does a Beaches resort provide more value to vacationing families?



SOURCE: [Thorsten Technoman](#).

Firms typically segment markets and then identify different target markets, or groups of customers, they want to reach when they are developing their value propositions. Be aware that companies sometimes develop unique value propositions for different target markets just as individuals may develop a unique value proposition for different employers. The value proposition tells each group of customers (or potential employers) why they should buy a product or service, vacation to a particular destination, donate to an organization, hire you, and so forth.

Once the benefits of a product or service are clear, the firm must develop strategies that support the value proposition. The value proposition serves as a guide for this process. With our sales consulting firm, the strategies it develops must help clients improve their sales by 30% to 50%. Likewise, if a company's value proposition states that the firm is the largest retailer in the region with the most stores and best product selection, opening stores or increasing the firm's inventory might be a key part of the company's strategy. Looking at Amazon's value proposition, "Low price, wide

selection with added convenience anytime, anywhere,” one can easily see how Amazon has been so successful.<sup>55</sup>

Individuals and students should also develop their own personal value propositions. Tell companies why they should hire you or why a graduate school should accept you. Show the value you bring to the situation. A value proposition will help you in different situations. Think about how your internship experience and/or study abroad experience may help a future employer. For example, explain to the employer the benefits and value of going abroad. Perhaps your study abroad experience helped you understand customers that buy from Company X and your customer service experience during your internship increased your ability to generate sales, which improved your employer’s profit margin. Thus, you may quickly contribute to Company X, something that they might very much value.

## Value Proposition Canvas

The Value Proposition Canvas (see Figure below) is a tool focusing on what the customer values and needs regarding a product or service that was developed by Dr Alexander Osterwalder ([link](#)) explains:

**Gain Creators:** *How* can you improve the lives of your customers?

**Pain Relievers:** *How* can you help relieve customer barriers/issues?

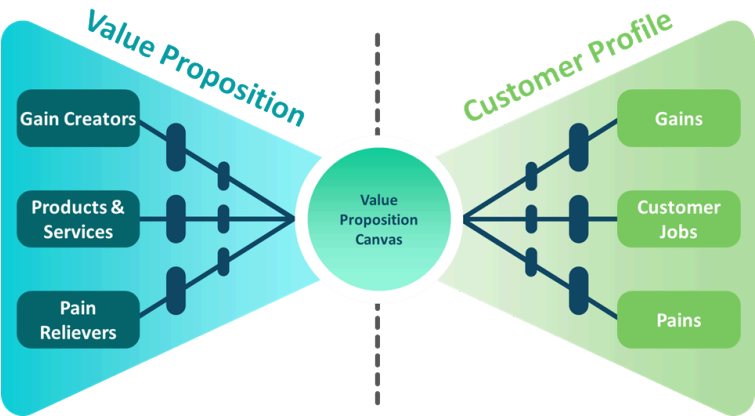
**Products & Services:** *What* products or services can you offer to help customers satisfy a need, want, or desire?

**Customer Jobs:** *What* are your customers needs, wants, or desires (emotional and/or personal)?

**Gains:** *How* will your customers benefit? (Expectations, social benefits, functional, and financial gains).

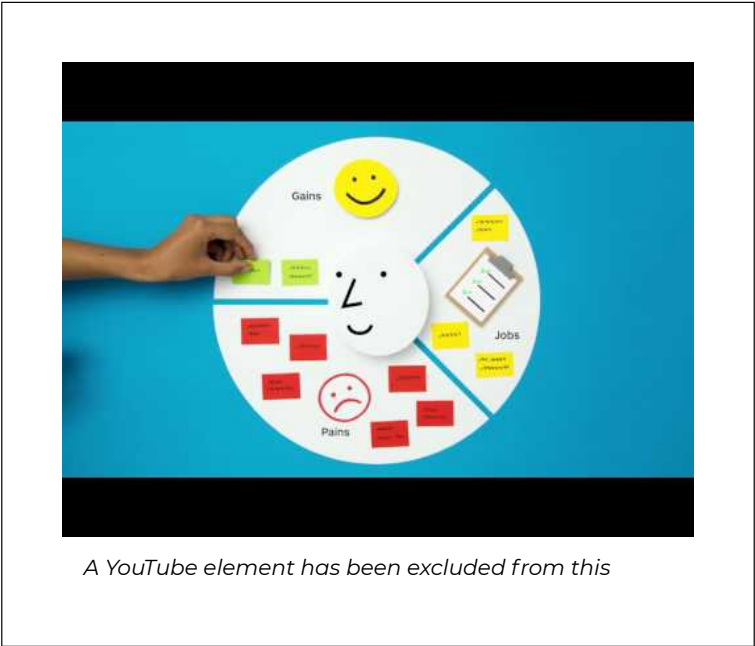
**Pains:** Are your customers experiencing barriers to basic activities?

Figure 1. Value Proposition Canvas



SOURCE: Business Model Inc.

Video 1. Strategyzer's Value Proposition Canvas Explained



*A YouTube element has been excluded from this*

version of the text. You can view it online here:

<https://pressbooks.library.upei.ca/startup/?p=490>

([Video Link](#))

### *Key Takeaways*

A value proposition is a 30-second “elevator speech” stating the specific value a product or service provides for a target market. Firms may develop unique value propositions for distinct customers. The value proposition shows why the product or service is superior to competing offers and why the customer should buy it or why a firm should hire you.

## **Review Questions**

- What is a value proposition?
- Create a value proposition and use it as your 30-second “elevator speech” to get the company interested in hiring you or talking to

you more.

## Effective Business Communication

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SOURCE: [Alex Andrews](#).

*“Communication leads to community, that is, to understanding, intimacy and mutual valuing.”*

- Rollo May

*"I know that you believe that you understood what you think I said, but I am not sure you realize that what you heard is not what I meant."*

• Robert J. McCloskey

Communication is an activity, skill, and art that incorporates lessons learned across a wide spectrum of human knowledge. Perhaps the most time-honoured form of communication is storytelling. We have told each other stories for ages to help make sense of our world, anticipate the future, and certainly to entertain ourselves. The art of storytelling draws on your understanding of yourself, your message, and how you communicate it to an audience that is simultaneously communicating back to you. Your anticipation, reaction, and adaptation to the process will determine how successfully you can communicate. You were not born knowing how to write or even how to talk, but in growing up, you have undoubtedly learned how to (and not) tell a story out loud and in writing.

You did not learn to text in a day and did not learn all the codes from LOL (laugh out loud) to BRB (be right back) right away. In the same way, learning to communicate well requires you to read and study how others have expressed themselves, then adapt what you have learned to your present task—whether it is texting a brief message to a friend, presenting your qualifications in a job interview, or writing a business report. You come to this text with skills and an understanding that will provide a valuable foundation as we explore the communication process.

Effective communication takes preparation, practice, and persistence. There are many ways to learn communication skills; the school of experience, or “hard knocks,” is one of them. In the business environment, a “knock” (or lesson learned) may come at the expense of your credibility through a blown presentation. The classroom environment can offer you a trial



run to try out new ideas and skills to communicate effectively, make a sale or form a new partnership. Listening to yourself, or perhaps the comments of others, may help you reflect on new ways to present, or perceive, thoughts, ideas, and concepts. The net result is your growth; ultimately your ability to communicate in business will improve, opening more doors than you might expect.

The degree to which you attend to each part will ultimately help give you the skills, confidence, and preparation to use communication in furthering your career.

## Why Is It Important to Communicate Well?

### *Learning Objectives*

Recognize the importance of communication in gaining a better understanding of yourself and others.

- Explain how communication skills help you solve problems, learn new things, and build your career.

Communication is key to your success, in relationships, workplace, as a citizen, and across your lifetime. Your ability to communicate comes from experience, which can be an effective teacher. You can learn from their lessons and be a more effective communicator.

Business communication can be a problem-solving activity to address:

- What is the situation?
- What are some communication strategies?
- What is the best course of action?
- What is the best way to design the chosen message?
- What is the best way to deliver the message?

In this book, we will examine this problem-solving process and help you learn to apply it in the kinds of situations you are likely to encounter over the course of your career.

## **Communication Influences Your Thinking**

We all share a fundamental drive to communicate. We can define communication as understanding and sharing meaning (Pearson & Nelson, 2000). You share meaning in what you say and how you say it, both in oral and written forms. If you were unable to communicate, what would your life be like? A series of never-ending frustrations? Being unable to communicate might even mean losing a part of yourself, for you communicate your self-concept (your sense of self and awareness of who you are). Perhaps someone told you do not articulate, or your grammar needs improvement. Does that make you more or less likely to want to communicate? For some, it may be a positive challenge, while for others it may be discouraging. In all cases, your ability to communicate is central to your self-concept.

Look at your clothes, what are the brands you are wearing? What do you think they say about you? Do you feel that certain styles of shoes, jewellery, tattoos, music, or even automobiles express who you are? Part of your self-concept may be that you express yourself through texting, or through

writing longer documents like essays and research papers, or through the way you speak. Your communications skills help you understand others, through their tone of voice, nonverbal gestures, or the format of written documents. These clues give insight about who they are and what their values and priorities may be. Active listening and reading are also part of being a successful communicator.

## **Communication Influences How You Learn**

When you were an infant, you learned to talk over a period of months. When you got older, you did not learn to ride a bike, drive a car, or even text a message on your cell phone in one moment. You need to begin improving your speaking and writing with the frame of mind that it will require effort, persistence, and self-correction.

You learn to speak in public by first having conversations, then by answering questions and expressing your opinions in class, and finally by preparing and delivering a “stand-up” speech. Similarly, you learn to write by first learning to read, then by writing and learning to think critically. Your speaking and writing are reflections of your thoughts, experience, and education. Part of that combination is your level of experience listening to other speakers, reading documents and styles of writing, and studying formats like what you aim to produce.

As you study business communication, you may receive suggestions for improvement and clarification from speakers and writers more experienced than yourself. Take their suggestions as challenges to improve and do not give up when your first speech or draft does not communicate the message you intend. Stick with it until you get it right. Your success in communicating is a skill that applies to almost every field of work and enhances your relationships. Remember, luck

is simply a combination of preparation and timing. You want to be prepared to communicate well when given the opportunity. Each time you do a good job, your success will bring more success.

## **Communication Represents You**

You want to make a good first impression to convey a positive image. In your career, you will represent your business or company in spoken and written form. Your professionalism and attention to detail will reflect positively on you and set you up for success. In both oral and written situations, you will benefit from having the ability to communicate clearly. These are skills you will use for the rest of your life. Positive improvements in these skills will enrich your relationships, prospects for employment, and ability to make a difference.

## **Communication Skills Are Desirable**

Employer surveys consistently ranked oral and written communication proficiencies in the top ten desirable skills year after year. In fact, high-powered business executives sometimes hire consultants to coach them in sharpening their communication skills. According to the National Association of Colleges and Employers, the following are the top five personal qualities or skills potential employers seek:

- Communication skills (verbal and written)

- Strong work ethic

- Teamwork skills (works well with others, group communication)

- Initiative

- Analytical skills

Knowing this, you can see that one way for you to be successful and increase your promotion potential is to increase your abilities to speak and write effectively.

In September 2004, the National Commission on Writing for America's Families, Schools, and Colleges published a study on 120 human resource directors finding that "writing is both a 'marker' of high-skill, high-wage, professional work and a 'gatekeeper' with clear equity implications," said Bob Kerrey, chair of the commission. "People unable to express themselves clearly in writing limit their opportunities for professional, salaried employment" (The College Board, 2004). They estimate that over 40 million Americans are illiterate or unable to functionally read or write. If you are reading this book, you may not be part of an at risk group in need of basic skill development, but you still may need additional training and practice as you raise your skill level. An individual with excellent communication skills is an asset to every organization. No matter what career you plan to pursue, learning to express yourself professionally in speech and in writing will help you get there.



SOURCE: [August de Richelieu](#). Effective communication skills are assets that will get you there.

### *Key Takeaways*

Communication forms a part of your self-concept, and it helps you understand yourself and others, solve problems and learn new things, and build your career.

### *Exercises*

Imagine that they have hired you to make “cold calls” to ask people whether they are familiar with a new restaurant that has just opened in your neighbourhood. Write a script for the phone call. Ask a classmate to co-present as you deliver the script orally in class, as if you were making a phone call to the classmate. Discuss your experience with the rest of the class.

Imagine you have been asked to create a job description. Identify a job, locate at least two sample job descriptions, and create one. Please present the job description to the class and note to what degree communication skills play a role in the tasks or duties you have included.

# What Is Communication?

## *Learning Objectives*

- Define communication and describe communication as a process.
- Identify and describe the eight essential components of communication.
- Identify and describe two models of communication.

We have proposed many theories to describe, predict, and understand the behaviours and phenomena of which communication consists. When communicating in business, we are often less interested in theory than in making sure our communications generate results. To achieve results, it is valuable to understand what communication is and how it works.

## Defining Communication

The root of the word “communication” in Latin is *communicare*, which means to share, or to make common (Weekley, 1967). They define communication as understanding and sharing meaning (Pearson & Nelson, 2000). At the focal point of our study on communication is the relationship that involves interaction between participants. This definition serves us well with its emphasis on the process which we will

examine in-depth across this text of coming to understand and share another's point of view effectively.

**Process** is a dynamic activity where sequential actions to achieve a particular end (Pearson & Nelson, 2000). Imagine you are alone in your kitchen thinking and your mother enters to talk briefly. What has changed? Now, imagine someone else joins (you have not met before) and this stranger listens intently as you speak. Your perspective might change, and you might watch your words more closely. The feedback or response from your mother and the stranger (your audience) may cause you to re-evaluate what you are saying (factors influence communication).

**Understanding:** *"To understand is to perceive, to interpret, and to relate our perception and interpretation to what we already know"* (McLean, 2003). If a friend tells you a story about falling off a bike, what image comes to mind? Now your friend points out the window and you see a motorcycle lying on the ground. Understanding the words and the concepts or objects they refer to is an important part of the communication process.

**Sharing** means doing something together with one or more people, like compiling a report or resource, such as pizza. In communication, sharing occurs when you convey thoughts, feelings, ideas, or insights to others. You can also share with yourself (a process called intrapersonal communication) when you bring ideas to consciousness, ponder, or figure out the solution to a problem and have a classic "Aha!" moment when something becomes clear.

**Meaning** is what we share through communication. The word "bike" represents both a bicycle and a short name for a motorcycle. Using the context and use of meaning, we can discover and understand the message.

## **Eight Essential Components of**



# Communication

To better understand the communication process, we can break it down into a series of eight essential components:

Figure 2. Communication Process



Each of these eight components serves an integral function in the overall process.

## Source

The source imagines, creates, and sends the message. In a public speaking situation, the source is the person giving the speech. He or she conveys the message by sharing additional information with the audience. The speaker also conveys a message through his or her tone of voice, body language, and choice of clothing. The speaker begins by first determining the message – what to say and how to say it. The second step involves encoding the message by choosing just the right order or the perfect words to convey the intended meaning. The third step is to present or send the information to the receiver or audience. Finally, by watching for the audience's reaction, the source perceives how well they received the message and responds with clarification or supporting information.

# Message

“The message is the stimulus or meaning produced by the source for the receiver or audience” (McLean, 2005). When you plan to give a speech or write a report, your message may seem to be only the words you choose that will convey your meaning by using grammar and organization. You may choose to save your most important point for last. The message also comprises the way you say it (in a speech, with your tone of voice, your body language, and your appearance) and in a report, with your writing style, punctuation, and the headings and formatting you choose. Part of the message may be the environment or context you present it in and the noise that might make your message hard to hear or see.

Imagine, for example, that you are addressing a large audience of sales reps and are aware there is a World Series game tonight. Your audience might have a hard time settling down, but you may choose to open with, “I understand there is an important game tonight.” By expressing verbally something that most people in your audience are aware of and interested in, you might grasp and focus their attention.

# Channel

“The channel is the way in which a message or messages travel between source and receiver” (McLean, 2005). For example, think of your television. How many channels do you have on your television? Each channel takes up some space (even in a digital world), in the cable or in the signal that brings the message of each channel to your home. Television combines an audio signal you hear with a visual signal you see. Together they convey the message to the receiver or audience. Turn off the volume on your television. Can you still understand

what is happening? The body language conveys part of the message in the show. Now, turn up the volume but turn around so that you cannot see the television. You can still hear the dialogue and follow the story.

When you speak or write, you are using a channel to convey your message. Spoken channels include face-to-face conversations, speeches, telephone conversations, and voice mail messages, radio, public address systems, and voice over Internet protocol (VoIP). Written channels include letters, memorandums, purchase orders, invoices, newspaper, and magazine articles, blogs, email, text messages, tweets, and so forth.

## Receiver

“The receiver receives the message from the source, analyzing and interpreting the message in ways both intended and unintended by the source” (McLean, 2005). To better understand this component, think of a receiver on a football team. The quarterback throws the football (message) to a receiver who must see and interpret where to catch the ball. The quarterback may intend for the receiver to “catch” his message in one way, but the receiver may see things differently and miss the football (the intended meaning) altogether.

As a receiver you listen, see, touch, smell, and/or taste to receive a message. Your audience “sizes you up,” much as you might check them out long before you take the stage or open your mouth. The nonverbal responses of your listeners can serve as clues on how to adjust your opening. By imagining yourself in their place, you expect what you would look for if you were them. Just as a quarterback plans where the receiver will be on the field to place the ball correctly, you too can recognize the interaction between source and receiver in a

business communication context. All of this happens illustrating why and how communication is always changing.

## Feedback

When you respond to the source, intentionally or unintentionally, you are giving feedback. Feedback are the messages the receiver sends back to the source. Verbal or nonverbal, all these feedback signals allow the source to see how well, how accurately (or how poorly and inaccurately) the message is received. Feedback also provides an opportunity for the receiver or audience to ask for clarification, to agree or disagree, or to show that the message can be more interesting. As the amount of feedback increases, the accuracy of communication also increases (Leavitt & Mueller, 1951).

For example, suppose you are a sales manager taking part in a conference call with four sales reps. As the source, you want to tell the reps to take advantage of the fact that it is World Series season to close sales on baseball-related sports gear. You state your message, but you hear no replies from your listeners. You might assume that this means they understood and agreed with you, but later in the month you might be disappointed with few sales. If you followed up your message with a request for feedback (“Does this make sense? Do any of you have questions?”) you might clarify your message, and to find out whether any of the sales reps believed your suggestion would not work with their customers.

## Environment

“The environment is the atmosphere, physical and psychological, where you send and receive messages” (McLean,

2005). The environment can include physical attributes (i.e. tables, chairs, lighting, and sound equipment), room itself, and it can also include factors like formal dress (i.e. open and caring or more professional and formal). People may be more likely to have an intimate conversation when they are physically close to each other, and less likely when they can only see each other from across the room. In that case, they may text each other, itself an intimate form of communication that is influenced by the environment. Your environment (as a speaker) will impact and play a role in your speech. It is always a good idea to check out where you will speak before the day of the actual presentation.

## Context

“The context of the communication interaction involves the setting, scene, and expectations of the individuals involved” (McLean, 2005). A professional communication context may involve business suits (environmental cues) that directly or indirectly influence expectations of language and behaviour among the participants.

A presentation or discussion does not take place as an isolated event. The degree to which the environment is formal or informal depends on the contextual expectations for communication held by the participants. The person sitting next to you may be used to informal communication with instructors, but this instructor may be used to verbal and nonverbal displays of respect in the academic environment. You may be used to formal interactions with instructors as well, and find your classmate’s question of “Hey Teacher, do we have homework today?” as rude and inconsiderate when they see it as normal. The nonverbal response from the instructor will certainly give you a clue about how they perceive the interaction, both the word choices and delivery.



SOURCE: [Jopwell](#).

Context is all about what people expect from each other, and we often create those expectations out of environmental cues. Traditional gatherings like weddings or quinceañeras are often formal events. There is a time for quiet social greetings, a time for silence as the bride walks down the aisle, or the father may have the first dance with his daughter as she transforms from a girl to womanhood in the eyes of her community. In either celebration there may come a time for rambunctious celebration and dancing. You may give a toast, and the wedding or quinceañera context will influence your presentation, timing, and effectiveness.

In a business meeting, who speaks first? That probably has some relation to the position and role each person has outside the meeting. Context plays a very important role in communication, particularly across cultures.

# Interference

Interference, also called noise, can come from any source. “Interference is anything that blocks or changes the source’s intended meaning of the message” (McLean, 2005). For example, if you drove a car to work or school, chances are you are surrounded by noise. Car horns, billboards, or perhaps the radio in your car interrupted your thoughts, or your conversation with a passenger.

Psychological noise happens when your thoughts occupy your attention while you are hearing, or reading, a message. Imagine that it is 4:45 p.m. and your boss, who is at a meeting in another city, emails you are asking for last month’s sales figures, an analysis of current sales projections, and the sales figures from the same month for the past five years. You may open the email, read, and think, “Great, no problem, I have those figures and that analysis right here in my computer.” You fire off a reply with last month’s sales figures and the current projections attached. Then, at five o’clock, you turn off your computer and go home. The next morning, your boss calls on the phone to tell you they are inconvenienced because you neglected to include the sales figures from the previous years. What was the problem? Interference: by thinking about how you wanted to respond to your boss’s message, you prevented yourself from reading attentively to understand the entire message.

Interference can come from other sources, too. Perhaps you are hungry, and your attention to your current situation interferes with your ability to listen. Maybe the office is hot and stuffy. If you were a member of an audience listening to an executive speech, how could this impact your ability to listen and take part?

Noise interferes with normal encoding and decoding of the message carried by the channel between source and receiver. Not all noise is bad, but noise interferes with the

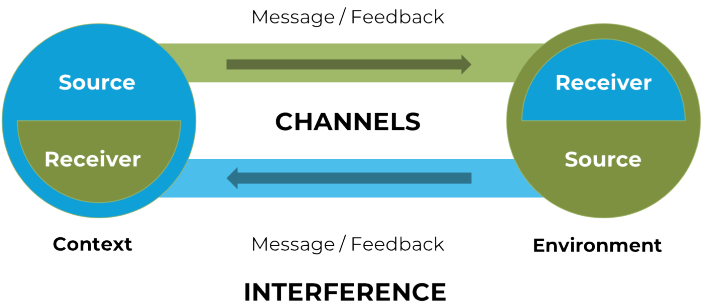
communication process. For example, your cell phone ringtone may be a welcome noise to you, but it may interrupt the communication process in class and bother your classmates.

## Two Models of Communication

Researchers have observed that when communication takes place, the source, and the receiver may send messages often overlapping. You, as the speaker, will often play both roles as source and receiver. You will focus on the communication and the reception of your messages to the audience. The audience will respond as feedback that will give you important clues. While there are many models of communication, here we will focus on two that offer perspectives and lessons for business communicators.

Rather than looking at the source sending a message and someone receiving it as two distinct acts, researchers often view communication as a transactional process (see Figure below “Transactional Model of Communication”), with actions often happening at the same time. The distinction between source and receiver is blurred in conversational turn-taking (i.e. where both participants play both roles simultaneously).

Figure 3. Transactional Model of Communication



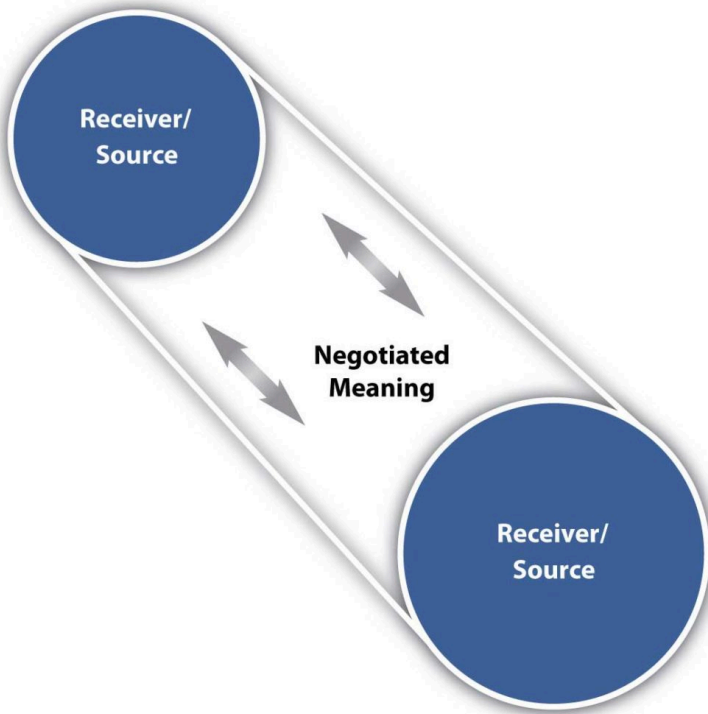
Researchers have also examined the idea that we all construct our own interpretations of the message. As the State



Department quote at the beginning of this chapter shows, what I said and what you heard may be different. In the constructivist model (see Figure below “Constructivist Model of Communication”), we focus on the negotiated meaning, or common ground, when trying to describe communication (Pearce & Cronen, 1980),

Imagine that you are visiting Atlanta, Georgia, and go to a restaurant for dinner. When asked if you want a “Coke,” you may reply, “sure.” The server may then ask you again, “what kind?” and you may reply, “Coke is fine.” They may ask a third time, “what kind of soft drink would you like?” In Atlanta, (the home of The Coca-Cola Company), they generically referred most soft drinks to as “Coke.” When you order a soft drink, you need to specify what type, even if you wish to order a beverage that is not a cola or not even made by the Coca-Cola Company. To someone from other regions of the United States, the words “pop,” “soda pop,” or “soda” may be the familiar way to refer to a soft drink; not necessarily the brand “Coke.” To communicate effectively, each person must realize what the term means for each other and establish common ground to understand the request and provide an answer.

Figure 4. Constructivist Model of Communication



Because we carry the multiple meanings of words, gestures, and ideas within us, we can use a dictionary to guide us, but we will still need to negotiate meaning.

#### *Key Takeaways*

The communication process involves understanding, sharing, and meaning, and it comprises eight essential elements: source, message, channel, receiver, feedback, environment, context, and interference. Among the

models of communication are the transactional process, in which actions happen simultaneously, and the constructivist model, which focuses on shared meaning.

### *Exercises*

- Draw what you think communication looks like. Share your drawing with your classmates.
- List three environmental cues and show how they influence your expectations for communication. Please share your results with your classmates.
- How does context influence your communication? Consider the language and culture people grew up with, and the role these play in communication styles.
- If you could design the perfect date, what activities, places, and/or environmental cues would you include to set the mood? Please share your results with your classmates.
- Observe two people talking. Describe their communication. See if you can find all eight components and provide an example for each one.
- What assumptions are present in the transactional model of communication? Find an

example of a model of communication in your workplace or classroom and provide an example for all eight components.

## Self-Understanding Is Fundamental to Communication

### *Learning Objectives*

- Describe the factors that contribute to self-concept.
- Describe how the self-fulfilling prophecy works.

Understanding your perspective can lend insight to your awareness, the ability to be conscious of events and stimuli. Awareness determines what you pay attention to, how you carry out your intentions, and what you remember of your activities and experiences each day. Awareness is a complicated and fascinating area of study. The way we take in information, give it order, and assign it meaning has long interested researchers from disciplines including sociology, anthropology, and psychology.

Your perspective is a major factor in this dynamic process. If you are aware of it, you bring to the act of reading this sentence a frame of mind formed from experiences and

education across your lifetime. Imagine that you see a presentation about snorkelling in beautiful Hawaii as part of a travel campaign. If you have never been snorkelling but love to swim, how will your perspective lead you to pay attention to the presentation? If, however, you had a traumatic experience as a child in a pool and are now afraid of being under water, how will your perspective influence your reaction?

Learning to recognize how your perspective influences your thoughts is a key step in understanding yourself and preparing to communicate with others.



SOURCE: [Daniel Torobekov](#). Peaceful or dangerous? Your perception influences your response.

The communication process itself is the foundation for oral and written communication. Whether we express ourselves in terms of a live, face-to-face conversation or across a voice over Internet protocol (VoIP) chat via audio and visual



channels, emoticons

, and abbreviations (IMHO

[In My Humble Opinion]], the communication process remains the same. Imagine that you are at work and your Skype program makes the familiar noise showing that someone wants to talk. Your caller ID tells you it is a friend. You also know that you have the report right in front of you to get done before 5:00 p.m. Your friend is quite a talker, and for him everything has a “gotta talk about it right now” sense of urgency. You know a little about your potential audience or conversational partner. Do you take the call? Perhaps you chat back “Busy, after 5,” only to have him call again. You interpret the ring as his insistent need for attention, but you have priorities. You can choose to close the Skype program, stop the ringing, and get on with your report, but do you? Communication occurs on many levels in several ways.

## Self-Concept

When we communicate, we are full of expectations, doubts, fears, and hopes. Where we place emphasis, what we focus on, and how we view our potential has a direct impact on our communication interactions. You gather a sense of self as you grow, age, and experience others and the world. At various times in your life, you have probably been praised and criticized, which may impact your confidence. We have learned much about ourselves through interacting with others. Not everyone has had positive influences in their lives, and not every critic knows what they are talking about, but criticism and praise still influence how and what we expect from ourselves.



SOURCE: [Eternal Happiness](#).

Carol Dweck, a psychology researcher at Stanford University, states that “something that seems like a small intervention can have cascading effects on things we think of as stable or fixed, including extroversion, openness to new experience, and resilience.” (Begley, 2008) Your personality and expressions (i.e. oral and written communication) are thought to have a genetic component:

*“More and more research is suggesting that, far from being simply encoded in the genes, much of personality is a flexible and dynamic thing that changes over the life span and is shaped by experience” (Begley, 2008).*

If you were told by someone that you were not a good speaker, know this: You can change. You can shape your performance through experience, and a business communication course, a mentor at work, or even reading effective business communication authors can cause positive change.

# Attitudes, Beliefs, and Values

When you consider what makes **you**, the answers multiply as do the questions. As a baby, you learned to recognize that the face in the mirror was your face. As an adult, you wonder what and who you are. Let us focus on self, which is defined as one's own sense of individuality, motivations, and personal characteristics (McLean, 2003). We also must keep in mind that this concept is not absolute because it changes throughout our lifetimes.

One point of discussion useful for our study about ourselves as communicators is to examine our attitudes, beliefs, and values. These are all interrelated, and researchers have varying theories which comes first and which springs from another. We learn our values, beliefs, and attitudes through interaction with others. The Table below "Attitudes, Beliefs, and Values" defines these terms and provides an example of each.

Table 1. Attitudes, Beliefs, and Values



	Definition	Changeable?	Example
<b>Attitudes</b>	Learned predispositions to a concept or object	Subject to change	I enjoyed the writing exercise in class today.
<b>Beliefs</b>	Convictions or expressions of confidence	Can change over time	This course is important because I may use the communication skills I am learning in my career.
<b>Values</b>	Ideals that guide our behaviour	Generally long-lasting	Effective communication is important.

An attitude is your immediate disposition toward a concept or an object. Attitudes can change easily and frequently. You may prefer vanilla while someone else prefers peppermint, but if someone tries to persuade you of how delicious peppermint is, you may try it and find that you like it better.

Beliefs are ideas based on our previous experiences and convictions and may not have basis on logic or fact. You no doubt have beliefs on political, economic, and religious issues. These beliefs may not have formed through rigorous study, but you hold them as important aspects of self. Beliefs often serve as a frame of reference through which we interpret our world. Although they can change, it often takes time or sound evidence to persuade someone to change a belief.



SOURCE: [Jennifer Enujiugha](#).

Values are core concepts and ideas of what we consider good or bad, right or wrong, or what is worth the sacrifice. Our values are central to our self-image, what makes us who we are. Like beliefs, we may not base our values on empirical research or rational thinking, but they are even more resistant to change than are beliefs. To undergo a change in values, a person may need to undergo a transformative life experience.

For example, suppose you highly value the freedom to make personal decisions, including the freedom to choose whether to wear a helmet while driving a motorcycle. This value of individual choice is central to your way of thinking, and you are unlikely to change this value. If your brother was driving a motorcycle without a helmet and suffered an accident that fractured his skull and left him with permanent brain damage, you might reconsider this value. While you might still value freedom of choice in many areas of life, you might become an advocate for helmet laws, and perhaps also for other forms of highway safety, such as stiffer penalties for texting while driving.

## Self-Image and Self-Esteem

Your self-concept is two fundamental elements: self-image and self-esteem. Your self-image is how you see yourself, how you would describe yourself to others. It includes your physical characteristics (eye colour, hair length, height, and so forth). It also includes your knowledge, experience, interests, and relationships. In creating the personal inventory in this exercise, you identified many characteristics that contribute to your self-image. Image involves not just how you look, but also your expectations of yourself and what you can be.

What is your image of yourself as a communicator? How do you feel about your ability to communicate? While the two responses may be similar, they show different things. Your self-esteem is how you feel about yourself, your feelings of self-worth, self-acceptance, and self-respect. Healthy self-esteem can be important when you experience a setback or a failure. Instead of blaming yourself or thinking, "I'm just no good," high self-esteem will enable you to persevere and give yourself positive messages like "If I prepare well and try harder, I can do better next time."

Putting your self-image and self-esteem together yields your self-concept: your central identity and set of beliefs about who you are and what you can accomplish. When communicating, your self-concept can play an important part because you may struggle or feel talented and successful. Either way, if you view yourself as someone capable of learning new skills and improving as you go, you will have an easier time learning to be an effective communicator. Whether positive or negative, your self-concept influences your performance and the expression of that essential ability: communication.

## Looking-Glass Self

Besides how we view ourselves and feel about ourselves, of course, we often take into consideration the opinions and behaviour of others. Charles Cooley's looking-glass self reinforces how we look to others and how they view us, treat us, and interact with us to gain insight into our identity. We place an extra emphasis on parents, supervisors, and those who have some control over us when we look at others. Developing a sense of self as a communicator involves a balance between constructive feedback and constructive self-affirmation. You judge yourself, as others do, and both views count.

## Self-Fulfilling Prophecy

Now, suppose that you are treated in an especially encouraging manner in one of your classes. Imagine that you have an instructor who continually “catches you doing something right” and praises you for your efforts and achievements. Would you be likely to do well in this class and perhaps take more advanced courses in this subject?

In a psychology experiment that has become famous through repeated trials, several public-school teachers were told that they expected specific students in their classes to do well because of their intelligence (Rosenthal & Jacobson, 1968). They identified these students as having special potential that had not yet “bloomed.” The teachers were unaware that these “special potential” students were randomly selected, and as a group, they had no more special potential than any other students.

Can you anticipate the outcome? As you may guess, the students lived up to their teachers' level of expectation.

Even though the teachers were supposed to give attention and encouragement to all students, in fact they unconsciously communicated special encouragement verbally and nonverbally to the special potential students. And these students, who were no more gifted than their peers, showed significant improvement by the end of the school year. This phenomenon came to be called the “Pygmalion effect” after the myth of a Greek sculptor named Pygmalion, who carved a marble statue of a woman so lifelike that he fell in love with her—and in response to his love she did in fact come to life and marry him (Rosenthal & Jacobson, 1968; Insel & Jacobson, 1975).



SOURCE: [Cottonbro](#).

In more recent studies, researchers have observed that the opposite effect can also happen when students are lacking potential, teachers tend to discourage them or, at a minimum, cannot give them adequate encouragement. As a result, the students do poorly (Schugurensky, 2009; Anyon, 1980; Oakes, 1985; Sadker & Sadker, 1994).

When people encourage you, it affects the way you see yourself and your potential. Seek encouragement for your writing and speaking. Actively choose positive reinforcement

as you develop your communication skills. You will make mistakes, but the important thing is to learn from them. Keep in mind that criticism should be constructive, with specific points you can address, correct, and improve.

The concept of a self-fulfilling prophecy, in which someone's behaviour comes to match and mirror others' expectations, is not new. Robert Rosenthal, a professor of social psychology at Harvard, has observed four principles while studying this interaction between expectations and performance:

- We form certain expectations of people or events.
- We communicate those expectations with various cues, verbal and nonverbal.
- People tend to respond to these cues by adjusting their behaviour to match the expectations.
- The outcome is that the original expectation becomes true.

### *Key Takeaways*

You can become a more effective communicator by understanding yourself and how others view you: your attitudes, beliefs, and values; your self-concept; and how the self-fulfilling prophecy may influence your decisions.

## *Exercises*

- How would you describe yourself as a public speaker? Now, five and ten years ago? Is your description the same or does it change across time? This business communication text and course can make a difference in what you might write for the category “year from today.”
- How does your self-concept influence your writing? Write a one- to two-page essay on this topic and discuss it with a classmate.
- Make a list of at least three of your strongly held beliefs. What are those beliefs based on? List some facts, respected authorities, or other evidence that support them. Share your results with your class.
- What are some values held by people, you know? Identify a target sample size (20 is a good number) and ask members of your family, friends, and peers about their values. Compare your results with those of your classmates.
- Make a list of traits you share with your family members. Interview them and see if anyone else in your family has shared them. Share and compare with your classmates.
- What does the field of psychology offer concern the self-fulfilling prophecy? Investigate the topic and share your findings.

# Diverse Forms of Feedback

## *Learning Objectives*

- Describe feedback as part of the writing process.
- Compare and contrast indirect and direct feedback.
- Understand internal and external feedback.
- Discuss diverse forms of feedback.

Just as you know that religion and politics are two subjects that often provoke emotional responses, you also recognize that once you are aware of someone's viewpoint you can choose to not discuss certain topics or may change the way you address them. The awareness of bias and preference, combined with the ability to adapt the message before they send it, increases the probability of reception and successful communication. Until now we have focused on knowing the audience's expectation and the assignment directions, as well as effective strategies for writing and production. Now, to complete the communication process, to close the writing process, we need to gather and evaluate feedback.

You may receive feedback from peers, colleagues, editors, or supervisors, but actual feedback from the intended audience can be rare. Imagine that you work in the marketing department of an engineering company and have written an article describing a new water pump that operates with little maintenance and less energy consumption than previous



models. Your company has also developed an advertising campaign introducing this new pump to the market and has added it to their online sales menu. Once your article has been reviewed and posted, a reader may access it online in another country who is currently researching water pumps that fall within your product range. That reader will see a banner ad displayed across the header of the Web page, with the name of your company prominently displayed in the reader's native language, even if your article is in English. These advertisements are *contextually relevant ads*. An example is Google's Feedback Ad function, which incorporates the content of the site and any related search data to provide information to potential customers. If the reader found your article through the German version of Google, Google.de, the ad will display the Adwords, or text in an advertisement, in German.

As the author, you may never receive direct feedback on your article, but you may receive significant indirect feedback. Google can report the "hits" and links to your Web site, and your company's information technology department can tell you about the hits on your Web site from Germany, where they originated, and whether the visitor started a sales order for the pump. If they left the sale incomplete, they know when the basket or order is abandoned or became inactive in the purchase process. If the sale was successful, your sales department can provide feedback as overall sales and information on specific customers. This allows you an opportunity for post-sales communication and additional feedback.

image

SOURCE: [Supercreat](#).

The communication process depends on a series of components that are always present. If you remove one or more, the process disintegrates. You need a source and a receiver, even if those roles alternate and blur. This includes

a message and a channel, or multiples of each in divergent ratios of signal strength and clarity, including the context and environment (including both the psychological expectations of the interaction and the physical aspects present). Interference is also part of any communication process. Because interference (internal or external) is always present, as a skilled business writer, you have learned how to understand and expect it so that you can get your message across to your audience.

The last step in the communication process is feedback. It contributes to the transactional relationship in communication and serves as part of the cycling and recycling of information, content, negotiations, relationships, and meaning between the source and receiver. Because feedback is so valuable to a business writer, you will welcome it and use strategies to overcome any interfering factors that may compromise reception and limit feedback.

**Feedback** is a receiver's response to a source and can come in many forms. From the change in the cursor arrow as you pass over a link as a response to the reader's sign, via the mouse, touch screen, or similar input device, as a nonverbal response, to one spoken out loud during a conversation, feedback is always present, even if we cannot capture the information.

## Indirect Feedback

If you have worked in an office, you may have heard of the grapevine, and may already know it often carries whines instead of wine. The grapevine is the unofficial or informal communication network within an organization, and characterized by rumor, gossip, and innuendo. The grapevine often involves information that is indirect, speculative, and not immediately verifiable, making it unreliable but interesting.

In the same way, indirect feedback is a response that does not directly come from the receiver or source. The receiver may receive the message, and may become the source of the response, but they may not communicate that response directly to you, the author. Your ability to track who accesses your Web page, what they read, and how long their visit lasts can be a source of feedback that serves to guide your writing. You may also receive comments, emails, or information from individuals within your organization about what customers have told them; this is another source of indirect feedback. The information not being communicated directly may limit its use or reliability, but it has value (which all forms of feedback have).

## **Direct Feedback**

You post an article about your company's new water pump and when you come back to it an hour later there are 162 comments. As you scroll through the comments, you find that ten potential customers are interested in learning more, while the rest debate the specifications and technical abilities of the pump. This direct response to your writing is another form of feedback.

Direct feedback is a response that comes from the receiver. Direct feedback can be both verbal and nonverbal, and it may involve signs, symbols, words, or sounds that are unclear or difficult to understand. You may send an email to a customer who inquired about your water pump, offering to send a printed brochure and have a local sales representative call to evaluate how suitable your pump would be for the customer's particular application. To do so, you will need the customer's mailing address, physical location, and phone number. If the customer replies simply with "Thanks!" (no address, no phone number) how do you interpret this direct feedback? Communication is dynamic and complex, and it is

no simple task to understand or predict. One aspect of the process, however, is predictable: feedback is always part of the communication process.

Just as nonverbal gestures do not appear independent of the context in which the communication interaction occurs, and often overlap, recycle, and repeat across the interaction, the ability to identify clear and direct feedback can be a significant challenge. In face-to-face communication, yawns, and frequent glances at the clock may serve as a clear signal (direct feedback) for lack of interest, but direct feedback for the writer is often less obvious. It is a rare moment when the article you wrote is read in your presence and direct feedback is immediately available (Often comes long after the publication).



SOURCE: [Tumisu](#).

## Internal Feedback

We usually think of feedback as something that can only come from others, but with internal feedback, we can get it from ourselves. The source generates internal feedback in

response to the message created by that same source. You, as the author, will be key to the internal feedback process. This may involve reviewing your document before you send it or post it, but it also may involve evaluation from within your organization.

On the surface, it may appear that internal feedback cannot come from anyone other than the author, but that would be inaccurate. If we go back to the communication process and revisit the definitions of source and receiver, we can clearly see each undefined role by just one person or personality, but within the transactional nature of communication by function. The source creates, and the receiver receives. Once the communication interaction is started, the roles often alternate, as with an email or text message “conversation” where two people take turns writing.

When you write a document for a target audience (for instance, a group of farmers who will use the pumps your company produces to move water from source to crop) you will write with them in mind as the target receiver. Until they receive the message, the review process is internal to your organization, and feedback is from individuals and departments other than the intended receiver.

You may have your company’s engineering department confirm the technical specifications of the information you incorporated into the document, or have the sales department confirm a previous customer’s address. In each case, you as the author are receiving internal feedback about content you produced, and in some ways, each department is contributing to the message prior to delivery.

Internal feedback starts with you. Your review of what you write is critical. You are the first and last line of responsibility for your writing. As the author, it is your responsibility to ensure your content is: correct, clear, concise, ethical.

When an author considers whether the writing in a

document is correct, it is important to interpret correctness broadly. The writing needs to be appropriate for the context of audience's expectations and assignment directions. Some writing may be technically correct, even polished, and still be incorrect for the audience or the assignment. Attention to what you know about your reading audience (e.g., their reading levels and educational background) can help address the degree to which that you have written is correct for its designated audience and purpose.

Correctness also involves accuracy: questions concerning true, false, and somewhere in between. A skilled business writer verifies all sources for accuracy and sleeps well knowing that no critic can say his or her writing is inaccurate. If you allow less than information into your writing, you open the door to accusations of false information that could be a fraudulent act with legal ramifications. Keep notes on where and when you accessed Web sites, where you found the information, you cite or include, and prepare to back up your statements with a review of your sources.

Writing correctly also includes providing current, up-to-date information. Most business documents place an emphasis on the time-sensitivity of the information. It makes little sense to rely on sales figures (information that is outdated) from two years ago when you can use sales figures from last year. Information that is not current can serve useful purposes, but often requires qualification on why it is relevant in a current context.

Business writing also needs to be clear, otherwise it will fail in its purpose to inform or persuade readers. Unclear writing can lead to misunderstandings that consume time and effort to undo. An old saying in military communications is "Whatever *can* be misunderstood, *will* be misunderstood." To give yourself valuable internal feedback about the clarity of your document, try to pretend you know nothing more about

the subject than your least informed reader does. Can you follow the information provided? Are your points supported?

In the business environment, time is money, and bloated writing wastes time. The advice from the best-selling style guide by William Strunk Jr. and E. B. White to “omit needless words” is always worth bearing in mind.



SOURCE: [Savvas Stavrinos](#).

Ethical consideration of the words you write, what they represent, and their consequences are part of the responsibility of a business writer. The writer offers information to a reading audience and losing credibility results in unlikely future interactions. Customer relationship management requires consideration of the context of the interaction, and all communication occurs with the context of community, whether that relationship is readily apparent. If the article is untruthful, this can negatively impact the brand management association and relationship with the product or services. Advertising may promote features, but false advertising can lead to litigation. The writer represents a business or organization, but also represents a family and a community.

For a family or community to function, there must be a sense of trust amid the interdependence.

## **External Feedback**

How do you know what you wrote was read and understood? Essentially, how do you know communication interaction has occurred? Writing, reading, and action based on the exchange of symbolic information reflects the communication process. Assessment of the feedback from the receiver is part of a writer's responsibility. Increasingly Web-based documents allow for interaction and enhancement of feedback, but you will still produce documents that may exist as hard copies. Your documents may travel to places you do not expect and cannot predict. Feedback comes in many forms and in this part of our discussion we focus on answering that essential question, assessing interaction, and gathering information from it. External feedback involves a response from the receiver. Receivers become a source of information themselves. Attention to the channel they use (how they communicate feedback), as well as nonverbal aspects like time (when they send it), can serve you on this and future documents.

## **Hard Copy Documents and External Feedback**

We will start this discussion with traditional, stand-alone hard copy documents in mind before we discuss electronic documents, including Web-based publications. Your business or organization may communicate in written forms across time zones and languages via electronic



communication, but they still produce some documents on paper. Offline technology (i.e. copy machine, printer) are still the tools you use as a normal course of business.

Letters are a common way of introducing information to clients and customers, and someone may task you to produce a document that is printed and distributed via “snail mail,” or the traditional post mail services. Snail mail is a term that reflects the time delay associated with the physical production, packaging, and delivery of a document. Legal documents are still largely in hard copy print form. So too are documents that address the needs of customers and clients that do not, or prefer not to, access information electronically.

Age is one characteristic of an audience that may tempt to focus on when considering who may need to receive a letter in hard copy form, but you may be surprised about this. In a 2009 study of U.S. Internet use, the Pew Research Centre (Horrigan, 2009) found between 2008 and 2009, broadband Internet use by senior citizens increased from 20% to 30%, and broadband use by baby boomers (people born 1945–1963) increased from 50% to 61%.

Socioeconomic status is a better characteristic to focus on when considering hard copy documents. Lack of access to a computer and the Internet is a reality for most of the world's population. It is often stated that half of the world's population will never make a phone call in their lifetime, and even though the references for the claims are widespread and diverse, that there are people without access to a phone is striking for many Westerners. While cell phones are increasingly allowing poor and rural populations to skip the investment in landline networks and wireless Internet is a leapfrog technology that changes everything, cell phones, and computers are still prohibitively expensive for many.

Say you work for a major bank on the West Coast of the United States. We have assigned you to write a letter offering a refinance option to a select, previously screened audience

composed of individuals who share several common characteristics: high-wage earners with exceptional credit scores. How will you best get the attention of this audience? If you emailed, it might get deleted as spam, or unwanted email that often lacks credibility and may even be dangerous. The audience is small, and you have a budget for hard copy production of documents that includes a line item for mailing costs. If the potential customer receives the letter from your department delivered by an overnight courier like FedEx, they may be more likely to receive your message.

In 2005, Wells Fargo Bank did exactly that. They mailed a letter of introduction outlining an opportunity to refinance at no cost to the consumer, targeting a group identified as high profit and low-risk. The channels selected (print-based documents on letterhead with the mode of delivery sure to get attention) prompted a response. The letter introduced the program, highlighted the features, and discussed why the customers were among a group of individuals for this offer (Diaz, 2005).

In the letter, the bank specifically solicited a customer response, feedback, via email and/or phone to establish dialogue. One could measure feedback in terms of response rate; in terms of verification of data on income, debt outstanding on loans, and current home appraisal values; and in terms of channel and how customers responded. All feedback has value to the author.

Hard copy documents can be a challenge for feedback, but that does not mean it is impossible to involve them in the feedback process. It's important to remember that even in the late 1990s, most business documents were print-based. From sales reports to product development reports, they are printed, copied, bound, and distributed, all at considerable cost.

A purpose of your letter is to persuade the client or customer to reply by email or phone, one way to assess feedback is the response rate, or the number of replies in

relation to the number of letters sent. If your report on a new product is prepared for internal use and targets a specific division within your company, their questions in relation to the document may serve as feedback. The memo can produce more questions and it should address in terms of policy, the negative feedback may highlight the need for revision. In each case, they often assess hard copy documents through oral and written feedback.

## **External Feedback in a Virtual Environment**

Rather than focus on the dust on top of documents once produced, perhaps read, and sometimes forgotten, let us examine document feedback from the interactive world that gathers no dust. One challenge when the Web was young involved the accurate assessment of audience. Why is that relevant to a business writer? Because you produce content for a specific audience with a specific purpose, and the degree to which it is successful has some relation to its value. Imagine that you produced a pilot television program with all the best characters, excellent dialogue, and big-name stars portraying the characters, only to see the pilot flop. If you had all the right elements in a program, how could it fail? It failed to attract an audience. Television often uses ratings, or measurements of the estimated number of viewers, to measure success. Nielsen is the leading market research company associated with television ratings and online content. Programs that get past a pilot or past a first season do so because they have good ratings and ranked above other competing programs. All programs compete within a time slot or across a genre. Those that are highly ranked (receiving the largest number of

viewers) can command higher budgets and often receive more advertising dollars.

Business writers experience a process of competition, ratings, feedback, and renewal within the world of online publishing. Business writers want their content to be read. Just as companies developed ways to measure the number of viewers of a television program, which led to rankings that influenced which programs survived and prospered and which were cancelled, the Web has a system of keeping track of what gets read and by whom. Perhaps you have heard of hits, as in how many hits a Web site receives, but have you stopped to consider what hits represent within our discussion of feedback?

First, let us examine what a hit is. When a browser, like Internet Explorer or Firefox, receives a file from a Web server, they consider it a hit. They may keep your document on the company's Web server, or a computer dedicated to serving the online requests for information via the Internet. The Web server receives a request from the user and sends the files associated with the page; every Web page contains several files including graphics, images, and text. Each file request and receipt between server and browser counts as a hit, regardless of how many files each page contains. If you created an online sales catalogue with 20 images per page, 20 boxed text descriptions, and all the files for indicating colour, size, and quantity, your document could have quite a few hits with just one page request and only one viewer.

Do many hits on your document mean it was successful? Not necessarily. They have largely discredited hits or page views as a reliable measure of a document's effectiveness, popularity, or audience size. In fact, the word "hits" is sometimes humorously referred to as being the acronym for *how idiots track success*. Page views are a count of how many times they viewed a Web page, irrespective of the

number of files it contains. Each time a user or reader views the page counts as one page view.



SOURCE: [Szfphy](#).

Nielsen Online and Source.com are two companies that provide Web traffic rating services, and Google has also developed services to better enable advertisers to target specific audiences. They commonly track the number of unique visits a reader makes to a Web site, and use cookies, or small, time-encoded files that identify specific users, to generate data.

Another way to see whether they have read a document online is to present part of the article with a “reveal full article” button after a couple of paragraphs. If someone wants to read the entire article, the button needs to be clicked to display the rest of the content. Because this feature can annoy readers, many content providers also display a “turn off reveal full article” button to provide an alternative; Yahoo! News is an example of a site that gives readers this option.

Jon Kleinberg’s HITS (hyperlink-induced topic search) algorithm has become a popular and more effective way to rate Web pages (Kleinberg, 1998). HITS ranks documents by the links within the document, presuming that a good document is one that incorporates and references, providing links to,

other Web documents while also being frequently cited by other documents. Hubs, or documents with many links, in relation to authority pages, or frequently cited documents. This relationship of hubs and authority is mutually reinforcing, and if you can imagine a Web universe of 100 pages, the one with the most links and which is most frequently referred to wins.

As a business writer you will naturally want to incorporate authoritative sources and relevant content, but you will also want to attract and engage your audience, positioning your document as hub and authority within that universe. Feedback as links and references may be one way to assess your online document.

## **User-Generated Feedback**

Moving beyond the Web tracking aspects of feedback measurement in terms of use, let us examine user-generated responses to your document. Say you have reviewed the posts left by unique users to the comments section of the article. In some ways, this serves the same purpose as letters to the editor in traditional media. In newspapers, magazines, and other offline forms of print media, they produce an edition with a collection of content and then delivered to an audience. The audience includes members of a subscriber-based group with common interests, as well as those who read a magazine casually while waiting in the doctor's office. If an article generated interest, enjoyment, or outrage (or demanded correction), people would write letters in response to the content. They would publish select responses in the next edition. There is a time delay associated with this system that reflects the preparation, production, and distribution cycle of the medium. If they publish the magazine once a month, it takes a full month for user feedback to be presented in print.

For example, letters commenting on an article in the March issue would appear in the “Letters” section of the May issue.

Public relations announcements, product reviews, and performance data of your organization are available internally or externally via electronic communication. If you see a factual error in an article released internally, within minutes you may respond with an email and a file attachment with a document that corrects the data. In the same way, if the document is released externally, you can expect that feedback from outside your organization will be quick. Audience members may debate your description of the water pump, or openly question its effectiveness in relation to its specifications; they may even post positive comments. Customer comments, like letters to the editor, can be a valuable source of feedback.

Customer reviews and similar forms of user-generated content are increasingly common across the Internet. They often choose written communication as the preferred format; from tweets to blogs and commentary pages, to threaded, theme-based forums, person-to-person exchange is increasingly common. Still, as a business writer, you note that even with the explosion of opinion content, the tendency for online writers to cite a Web page with a link can promote interaction.

It may sound strange to ask this question, but is all communication interaction good? Let us examine examples of interaction and feedback and see if we can arrive at an answer.

You may have heard that one angry customer can influence several future customers, but negative customer reviews in the online information age can make a disproportionate impact in a relatively short time. While the online environment can be both fast and effective in terms of distribution and immediate feedback, it can also be quite ineffective, depending on the context. “Putting ads in front of Facebook users is like hanging out at a party and interrupting conversations to hawk merchandise,” according to Newsweek

journalist Daniel Lyons. Relationships between users, sometimes called social graphs, reflect the dynamic process of communication, and they hold value, but translating that value into sales can be a significant challenge.

Overall, as we have seen, your goal as a business writer is to meet the audience and employer's expectations concisely. Getting your content to a hub position, and including authoritative references, is a great way to make your content more relevant to your readers. Trying to facilitate endless discussions may engage and generate feedback but may not translate into success. Facebook serves as a reminder that you want to provide solid content and attend to the feedback. People who use Google already have something in mind when they perform a search, and if your content provides what readers are looking for, you may see your page views and effectiveness increase.

## **Interviews**

Interviews provide an author with the opportunity to ask questions of, and receive responses from, audience members. Since interviews take considerable time and cannot easily scale up to address large numbers of readers, they are most often conducted with a small, limited audience. An interview involves an interviewer, and interviewee, and a series of questions. It can be an employment interview, or an informational interview in preparation of document production, but in this case, we are looking for feedback. As a business writer, you may choose to schedule time with a supervisor to ask a couple of questions about how the document you produced could improve. You may also schedule time with the client or potential customer and try to learn more. You may interact across a wide range of channels, from face-to-face to an email exchange, and learn more about



how your document is received. Take care not to interrupt the interviewee, even if there is a long pause, as some of the best information comes up when people feel the need to fill the silence. Be patient and understanding and thank them for taking the time to take part in the interview. We build relationships over time and the relationship you build through a customer interview, for example, may have a positive impact on your next writing project.

## Surveys

At some point, you may have answered your phone to find a stranger on the other end asking you to take part in a survey for a polling organization like Gallup, Pew, or Roper. You may have also received a consumer survey in the mail, with a paper form to fill out and return in a postage-paid envelope. Online surveys are also becoming increasingly popular. For example, [SurveyMonkey.com](https://www.surveymonkey.com) is an online survey tool that allows people to respond to a set of questions and provide responses. This type of reader feedback can be valuable, particularly if some questions are open-ended. Closed questions require a simple yes or no to respond, making them easier to tabulate as “votes” but open-ended questions give respondents complete freedom to write their thoughts. They promote the expression of new and creative ideas and can lead to valuable insights for you, the writer.

Surveys can take place in person in an interview format, and this format is common when taking a census. For example, the U.S. government employs people for a short time to go door to door for a census count of everyone. Your organization may lack comparable resources and may choose to mail out surveys on paper with postage-paid response envelopes or may reduce the cost and increase speed by asking respondents to complete the survey online.

## Focus Groups

Focus groups involve a representative sample of individuals, brought together to represent a larger group or audience. If you know your target audience, and the range of characteristics they represent, you will look for participants who can represent over one of those characteristics. As we have discussed in an interview setting, the interaction involves a question-and-answer format but may also introduce other ways to facilitate interaction. If your company is looking to launch a new product, you may introduce that product to this select audience to see how they react. As a business writer, what they express may help you in writing your promotional materials. In terms of feedback, you may assemble a group of individuals who use your product or service, and then ask them a series of questions in a group setting. The responses may have bearing on your current and future documents.



SOURCE: [Luis Quintero](#).

Normally we would think of focus groups in a physical setting, but again modern technology has allowed for innovative adaptations. Forums, live Webcasts, and other

virtual gatherings allow groups to come together across time and distance to discuss specific topics. A Web camera, a microphone, and an Internet connection are all it takes. There are several software programs and online platforms for bringing individuals together. Expect that focus groups will increasingly gather via computer-mediated technologies in the future as the costs of bringing people together for a traditional meeting increase.

### *Key Takeaways*

Feedback may be indirect or direct, internal or external, and mediate electronically in many ways.

### *Exercises*

- Design a market survey that asks your friends at least three questions that have to do with their attitudes, preferences, or choices. Prepare and present your results, noting the number of respondents, and any characteristics that you requested or can offer, like age or level of education, for example.
- How does the online world affect the process of feedback on written documents? Does it improve

feedback, or lead to self-censorship? Discuss your thoughts with classmates.

- Are traditional print publications still viable with daily, weekly, or monthly publication cycles? Why or why not?
- Research online survey programs and review two competitors. Compare the features and the apparent ease of use. Which would you recommend and why? Report your results and compare with classmates.

## Footnotes

<sup>55</sup> “How Do You Develop a Unique Value Proposition?,” <http://www.infomarketerszone.com/public/182.cfm> (accessed February 12, 2012).

# 6/ Strategic Marketing

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Source: [Pixabay](#).

## Learning Objectives

- Define marketing and outline its components.

- Understand how marketing relates differently to varying target markets.
- Describe the personal and psychological factors that may influence what consumers buy and when they buy it.
- Explain how culture, subcultures, social classes, families, and reference groups affect consumers' buying behaviour.

## What is Marketing?

The American Marketing Association defines marketing as “the activity, set of institutions, and processes for creating, communicating, delivering, and exchanging offerings that have value for customers, clients, partners, and society at large.”<sup>56</sup> If you study the definition, you see that there are four activities, or components, of marketing:

- **Creating.** Collaborating with suppliers and customers to create offerings that have value.
- **Communicating.** Broadly, describing those offerings, as well as learning from customers.
- **Delivering.** Getting those offerings to the consumer in a way that optimizes value.
- **Exchanging.** Trading value for those offerings.

The traditional way of viewing the components of marketing is via the five Ps:

**Product.** Goods and services (creating offerings).

**Promotion.** Communication.

**Place.** Getting the product to a point at which the customer can purchase it (delivering).

**Price.** The monetary amount charged for the product (exchanging)

**People.**<sup>57</sup> Refers to the staff, salespeople, and those who work for the business. Decisions involving people is rooted in customer service.

Introduced in the early 1950s, the four Ps (the marketing mix), means that a marketing plan is a mix of these four components. If the five Ps are the same as creating, communicating, delivering, and exchanging, you might wonder why there was a change. The answer is that they are *not* the same. Product, price, place, promotion, and people are nouns. These words cannot capture all the activities of marketing. For example, exchanging requires mechanisms for a transaction, which comprise more than simply a price or place. Exchanging requires transferring ownership. For example, when you buy a car, you sign documents that transfer the car's title from the seller to you. That is part of the exchange process.

Figure 1.5 Ps Marketing Mix



The term *product*, which seems obvious, is limited. Does the product include services that come with your new car purchase (such as free maintenance for a certain period on some models)? Or does the product mean only the car itself?

# Consumer Behaviour: How People Make Buying Decisions

You have been a consumer with purchasing power for much longer than you probably realize, since you were asked which cereal or toy you wanted. Over the years, you have developed rules of thumb or mental shortcuts providing a systematic way to choose among alternatives, even if you are not aware of it. Other consumers follow a similar process, but different people, no matter how similar they are, make different purchasing decisions. You might be very interested in purchasing a Smart Car, but your best friend might want to buy a Ford F-150 truck. What factors influenced your decision and what factors influenced your friend's decision?

As we mentioned earlier in the chapter, many things, including environmental and marketing factors, influence consumer behaviour the situation, personal and psychological factors, family, and culture. Businesses try to figure out *trends* so they can reach the people most likely to buy their products in the most cost-effective way possible. Businesses often try to influence a consumer's behaviour with things they can control such as the layout of a store, music, grouping and availability of products, pricing, and advertising. While some influences may be temporary and others are long-lasting, different factors can affect how buyers behave, whether they influence you to make a purchase, buy additional products, or buy nothing at all. Let us now look at some influences on consumer behaviour in more detail.

## Situational Factors

Have you ever been in a department store and could not find your way out? No, you are not necessarily directionally



challenged. Marketing professionals take physical factors such as a store's design and layout into account when they are designing their facilities. Presumably, the longer you wander around a facility, the more you will spend. Grocery stores frequently place bread and milk products on the opposite ends of the stores because people often need both types of products. To buy both, they must walk around the store (which is loaded with other items they might see and purchase).

Store locations also influence behaviour. Starbucks has done a good job to locate its stores, you can scarcely drive a few miles down the road without passing a Starbucks. You can also buy cups of Starbucks coffee at many grocery stores and in airports, virtually any place where there is foot traffic.

Physical factors that firms can control, such as the layout of a store, music played at stores, the lighting, temperature, and even the smells you experience are called atmospherics. Perhaps you have visited the office of an apartment complex and noticed how great it looked and even smelled, because managers want you to stay and look at their facilities. Research shows that "*strategic fragrancing*" results in customers staying in stores longer, buying more, and leaving with better impressions of the quality of stores' services and products. Mirrors near hotel elevators are another example. Hotel operators have found that when people are busy looking at themselves in the mirrors, they do not feel like they are waiting as long for their elevators (Moore, 2008).

Not all physical factors are under a company's control, however. Take weather, for example. Rainy weather can be a boon to some companies, like umbrella makers such as Totes, but a problem for others. Beach resorts, outdoor concert venues, and golf courses suffer when it is pouring. Businesses such as automobile dealers also have fewer customers. Who wants to shop for a car in the rain?

Firms often attempt to deal with adverse physical factors such as poor weather by offering specials during

unattractive times. For example, many resorts offer consumers discounts to travel to beach locations during hurricane season. Having an online presence is another way to cope with weather-related problems. What could be more comfortable than shopping at home? If it is raining too hard to drive to the GAP, REI, or Abercrombie & Fitch, you can buy products from these companies and many others online. You can shop online for cars, too, and many restaurants take orders online and deliver.

Crowding is another situational factor. Have you ever left a store and not purchased anything because it was just too crowded? Some studies have shown that consumers feel better about retailers who attempt to prevent overcrowding in their stores. Other studies have shown that to a certain extent, crowding can have a positive impact on a person's buying experience. They often refer the phenomenon to as **herd behaviour** (Gaumer & Leif, 2005).

If we lined people up to buy something, you want to know why. Should you get in line to buy it too? Herd behaviour helped drive up the price of houses in the mid-2000s before the prices for them fell rapidly. Unfortunately, herd behaviour has also led to the deaths of people. In 2008, a store employee was trampled to death by an early morning crowd rushing into a Walmart to snap up holiday bargains.

Companies like Pampered Chef that sell their products at parties understand that the social situation makes a difference. When you are at a friend's Pampered Chef party, you do not want to look cheap or disappoint your friend by not buying anything. Certain social situations can also make you less willing to buy products. You might spend more money each month eating at fast food restaurants like McDonald's and Subway. Where do you take someone for your first date? Some people might take a first date to Subway, but other people might choose a restaurant that is more upscale. If you have turned down a drink or dessert on a date because you were

worried about what the person you were with might have thought, your consumption was affected by your social situation (Matilla & Wirtz, 2008).

Video 1. Thin Mints? Dairy Queen



*A YouTube element has been excluded from this version of the text. You can view it online here:*

<https://pressbooks.library.upei.ca/startup/?p=501>

([Video Link](#))

## Time

The time of day, time of year, and how much time consumers feel like they must shop affect what they buy. Researchers have even discovered whether someone is a “morning person” or “evening person” affects shopping patterns. When you are hungry or have cash, you may purchase

more than you would at other times. 7-Eleven Japan is a company that is extremely in tune with time and how it affects buyers. The company's point-of-sale systems at its checkout counters monitor what is selling well and when, and stores are restocked with those items immediately, sometimes via motorcycle deliveries that zip in and out of traffic along Japan's crowded streets. The goal is to get the products on the shelves when and where consumers want them. 7-Eleven Japan also knows that, like Americans, its customers are "*time starved*." Shoppers can pay their utility bills, local taxes, and insurance or pension premiums at 7-Eleven Japan stores, and even make photocopies (Bird, 2002).

Companies worldwide are aware of people's lack of time and are accommodating them. Some doctors' offices offer drive-through shots for patients who are in a hurry and for elderly patients who find it difficult to get out of their cars. Tickets.com allows companies to sell tickets by sending them to customers' mobile phones when they call in. Barcode scanners then read the phones' displays when the ticket purchasers arrive at the events they are attending. Likewise, if you need customer service from Amazon.com, there is no need to wait on the telephone. If you have an account with Amazon, you just click a button on the company's Web site and an Amazon representative calls you immediately.

## Reason for the Purchase

The reason you are shopping also affects the time you will spend shopping. Are you making an emergency purchase? What if you need something for an important dinner or a project and only have an hour to get everything? Are you shopping for a gift or for a special occasion? Are you buying something to complete a task/project and need it quickly? In recent years, emergency clinics have sprung up in strip malls all

over the country. Convenience is one reason. The other is sheer necessity. If you cut yourself and you are bleeding badly, you are probably not going to shop around much to find the best clinic. You will go to the one that is closest to you. The same thing may happen if you need something immediately.

Purchasing a gift might not be an emergency, but you might not want to shop much for it either. Gift certificates have been popular for years. You can purchase gift cards for many merchants at your local grocery store or online. Suppose you need to buy an engagement ring and choose to buy one online, but what if the diamond was fake? What if you had to return the ring? How hard would it be to return (Hornik & Miniero, 2009)?

## Mood

Have you ever felt like going on a shopping spree? At other times, wild horses could not drag you to a mall. People's moods temporarily affect their spending patterns. Some people enjoy shopping. It is entertaining for them. At the extreme are compulsive spenders who get a temporary "high" from spending.

A sour mood can spoil a consumer's desire to shop. The crash of the U.S. stock market in 2008 left many people feeling poorer, leading to a dramatic downturn in consumer spending. Penny pinching came into vogue, and conspicuous spending was out. Costco and Walmart experienced heightened sales of their low-cost Kirkland Signature and Great Value brands as consumers scrimped<sup>1</sup>. Saks Fifth Avenue was not so lucky. Its annual release of spring fashions usually leads to a feeding frenzy among shoppers, but spring 2009 was different. *"We've definitely seen a drop-off of this idea of shopping for entertainment,"* says Kimberly Gabel, Saks Fifth Avenue's senior vice president of marketing (Rosenbloom, 2009). To get

buyers in the shopping mood, companies resorted to different measures. The upscale retailer Neiman Marcus began introducing more mid-priced brands. By studying customer loyalty cards, the French hypermarket Carrefour hoped to get its customers to purchase non-food items that have higher profit margins.

The glum mood was not bad for all businesses. Discounters like Half-Price books saw their sales surge, as did seed sellers as people began planting their own gardens. Finally, what about those products (Aqua Globes, Snuggies, and Ped Eggs) you see being hawked on television? Their sales were the best. Apparently, consumers too broke to go on vacation or shop at Saks were instead watching television and buying the products (Ward, 2009).

## Personal Factors: Personality and Self-Concept

Personality describes a person's disposition, helps show why people are different, and encompasses a person's unique traits. The "Big Five" personality traits that psychologists discuss frequently include **openness** or how open you are to new experiences, **conscientiousness** or how diligent you are, **extraversion** or how outgoing or shy you are, **agreeableness** or how easy you are to get along with, and **neuroticism** or how prone you are to negative mental states.

Do personality traits predict people's purchasing behaviour? Can companies successfully target certain products for people based on their personalities? How do you find out what personalities consumers have? Are extraverts wild spenders and introverts penny pinchers?

The link between people's personalities and their buying behaviour is unclear. Research shows that "sensation

seekers,” or people who exhibit top levels of openness, are more likely to respond well to advertising that is violent and graphic. The problem for firms is figuring out “who’s who” in personalities.

Marketers have had better luck linking people’s self-concepts to their buying behaviour. Your self-concept is how you see yourself, be it positive or negative. Your ideal self is how you would *like* to see yourself, whether it is prettier, more popular, more eco-conscious, or more “goth,” and others’ self-concept, or how you think others see you, also influences your purchase behaviour. Marketing researchers believe people buy products to enhance how they feel about themselves, to get themselves closer to their ideal selves.

The slogan “Be All That You Can Be,” which for years was used by the U.S. Army to recruit soldiers, is an attempt to appeal to the self-concept. Presumably, by joining the U.S. Army, you will become a better version of yourself, which will improve your life. They advertise many beauty products and cosmetic procedures in a way that is supposed to appeal to the ideal “self” people seek. All of us want products that improve our lives.

## Social Situation

The social situation you are in can significantly affect your purchase behaviour. Perhaps you have seen Girl Scouts selling cookies outside grocery stores and other retail establishments and purchased nothing from them, but what if your neighbour’s daughter is selling the cookies? Are you going to turn her down or be a friendly neighbour and buy a box (or two)?

## Gender, Age, and Stage of Life

While demographic variables such as income, education, and marital status are important, we will look at gender, age, and stage of life and how they influence purchase decisions. Men and women need and buy different products (Ward & Thuhang, 2007). They also shop differently and in general, have different attitudes about shopping. You know the old stereotypes. Men see what they want and buy it, but women “try on everything and shop ‘til they drop.” There is some truth to the stereotypes. That is why you see so many advertisements directed at one sex or the other, beer commercials that air on ESPN and commercials for household products that air on Lifetime. Women influence fully two-thirds of all household product purchases, whereas men buy about three-quarters of all alcoholic beverages (Schmitt, 2008). The shopping differences between men and women seem to change. Younger, well-educated men are less likely to believe grocery shopping is a woman’s job and would be more inclined to bargain shop and use coupons if we properly targeted the coupons at them (Hill & Harmon, 2007). One survey found that approximately 45% of married men *like* shopping and consider it relaxing.

One study by Resource Interactive, a technology research firm, found that when shopping online, men prefer sites with lots of pictures of products and women prefer to see products online in lifestyle context, say, a lamp in a living room. Women are also twice as likely as men to use viewing tools such as the zoom and rotate buttons and links that allow them to change the colour of products. The video below highlights gender in product advertising.

Video 2. Heineken: What Women vs. Men Want





*A YouTube element has been excluded from this version of the text. You can view it online here:*

<https://pressbooks.library.upei.ca/startup/?p=501>

#### [\(Video Link\)](#)

Marketing to men is big business. Some advertising agencies specialize in advertisements designed specifically to appeal to male consumers. Many businesses today are taking greater pains to figure out “what men want.” Products such as face toners and body washes for men are growing in popularity (i.e. [Brickell](#), [Axe](#), [Weldon Barber](#), [Every Man Jack](#)), which some advertising agencies are focusing exclusively on men’s products. There are products such as kayaks and mountain bikes targeted to women that were not previously. Likewise, conscious brands are making greater appeals to Millennial’s, Generation Z’s and the celebration of diverse populations.



SOURCE: [cottonbro](https://cottonbro.com).

You have probably noticed that the things you buy have changed as you age. When you were a child, the last thing you probably wanted as a gift was clothing. As you became a teen, however, cool clothes probably became a bigger priority. Do not look now but depending on the stage of life you are currently in, diapers and wrinkle cream might be just around the corner.

If you are single and working after graduation, you probably spend your money differently than a newly married couple. Diapers and day care, orthodontia, tuition, electronics, regardless of the age, children affect the spending patterns of families. Once children graduate from college and parents are empty nesters, spending patterns change again.

Empty nesters and baby boomers are a vast market that companies are trying to tap. Ford and other car companies have created “ageing suits” for junior employees to wear when they are designing automobiles.<sup>58</sup> The suit simulates the restricted mobility and vision people experience as they get older. Car designers can then figure out how to configure the automobiles to better meet the needs of these consumers.



SOURCE: [Pixabay](#).

## Lifestyle

If you have ever watched the television show *Wife Swap*, you can see that despite people's similarities (i.e. being middle class Americans who are married with children), their lifestyles can differ radically. To better understand and connect with consumers, companies interview or ask people to complete questionnaires about their lifestyles or their activities, interests, and opinions (often referred to as AIO statements). Consumers are asked about products they like, where they live, and what their gender is but also how they spend their time and what their priorities, values, opinions, and general outlooks on the world are. Where do they go other than work? Who do they like to talk to? What do they talk about? Researchers hired by Procter & Gamble have followed women around for weeks as they shop, run errands, and socialize with one another (Berner, 2006). Other companies have paid people to keep a daily journal of their activities and routines.

Several research organizations examine lifestyle and psychographic characteristics of consumers. Psychographics

combines the lifestyle traits of consumers and their personality styles with an analysis of their attitudes, activities, and values to determine groups of consumers with similar characteristics. One of the most widely used systems to classify people based on psychographics is the VALS (Values, Attitudes, and Lifestyles) framework. Using VALS to combine psychographics with demographic information such as marital status, education level, and income provide a better understanding of consumers.

## Perception

Perception is how you interpret the world around you and make sense of it in your brain. You do so via stimuli that affect your different senses, sight, hearing, touch, smell, and taste. How you combine these senses also makes a difference. For example, in one study, consumers were blindfolded and asked to drink a new brand of clear beer. Most of them said the product tasted like regular beer. However, when the blindfolds came off, and they drank the beer, many of them described it as “watery” tasting (Ries, 2009).

Consumers are bombarded with messages on television, radio, magazines, the Internet, and even bathroom walls. We expose the average consumer to about 3,000 advertisements per day (Lasn, 1999). Consumers are surfing the Internet, watching television, and checking their cell phones for text messages simultaneously. Some information makes it into our brains. Selecting information, we see or hear (i.e. television shows or magazines) is called selective exposure.

Have you ever read or thought about something and then started noticing ads and information about it popping up everywhere? Many people are more perceptive to advertisements for products they need. Selective attention is filtering out information based on how relevant it is to you. It

has been described as a “suit of armour” that helps you filter out information you *do not* need. At other times, people forget information, even if it is quite relevant to them, which is called selective retention. Often the information contradicts the person's belief. A long time chain smoker who forgets much of the information communicated during an antismoking commercial is an example. To be sure their advertising messages get through to you and you remember them, companies use repetition. How tired of iPhone commercials were you before they tapered off? How often do you see the same commercial aired during a single television show?

Another potential problem that advertisers (or your friends) may experience is selective distortion or misinterpretation of the intended message. Promotions for weight loss products show models that look slim and trim after using their products, and consumers may believe they will look like the model if they use the product. They misinterpret other factors such as how the model looked before or how long it will take to achieve the results. Similarly, have you ever told someone a story about a friend and that person told another person who told someone else? By the time the story gets back to you, it is completely different. The same thing can happen with many types of messages.

image

SOURCES: [Coverr-Free-Footage](#); [Ezgif](#).

Using surprising stimuli or shock advertising is also a technique that works. One study found that shocking content increased attention, benefited memory, and positively influenced behaviour among a group of university students (Dahl, et al., 2003).

Subliminal advertising is the opposite of shock advertising and involves exposing consumers to marketing stimuli such as photos, ads, and messages by stealthily embedding them in movies, ads, and other media. Although there is no evidence that subliminal advertising works, years

ago the words *Drink Coca-Cola* were flashed for a millisecond on a movie screen. Consumers were thought to perceive the information subconsciously and to be influenced to buy the products shown. Many people considered the practice to be subversive, and in 1974, the Federal Communications Commission condemned it. Much of the original research on subliminal advertising, conducted by a researcher trying to drum up business for his market research firm was fabricated, although people are still fascinated by subliminal advertising (Crossen, 2007). To create “buzz” about the television show *The Mole* in 2008, ABC began hyping it by airing short commercials composed of just a few frames. If you blinked, you missed it. Some television stations called ABC to figure out what was going on. One-second ads were later rolled out to movie theatres (Adalian, 2008).

Different consumers perceive information differently. A couple of frames about *The Mole* might make you want to see the television show. However, your friend might see the ad, find it stupid, and never tune in to watch the show. One man sees Pledge, an outstanding furniture polish, while another sees a can of spray no different from any other furniture polish. One woman sees a luxurious Gucci purse, and the other sees an overpriced bag to hold keys and makeup (Chartrand, 2009).

## Learning

Learning refers to the process by which consumers change their behaviour after they gain information or experience. It is the reason you do not buy an inferior product twice. Learning does not just affect what you buy; it affects how you shop. People with limited experience about a product or brand generally seek more information than people who have used a product before.

Companies try to get consumers to learn about their

products in different ways. Car dealerships offer test drives. Pharmaceutical reps leave samples and brochures at doctor's offices. Other companies give consumers free samples. To promote its new line of coffees, McDonald's offered customers free samples to try. Have you ever eaten the food samples in a grocery store? While sampling is an expensive strategy, it gets consumers to try the product and many customers buy it, especially right after trying in the store.

Another kind of learning is operant or instrumental conditioning, which is what occurs when researchers can get a mouse to run through a maze for a piece of cheese or a dog to salivate just by ringing a bell. Learning occurs through repetitive behaviour that has positive or negative consequences. Companies engage in operant conditioning by rewarding consumers, which cause consumers to want to repeat their purchasing behaviours. Prizes and toys that come in Cracker Jacks and McDonald's Happy Meals, free tans offered with gym memberships, a free sandwich after a certain number of purchases, and free car washes when you fill up your car with a tank of gas are examples.

Another learning process called classical conditioning occurs by associating a conditioned stimulus with an unconditioned stimulus to get a particular response. The more frequently the conditioned stimulus is linked with the unconditional stimulus, the faster learning occurs, and this is what advertisers and businesses try to do. Think about a meal at a restaurant where the food was good, and you went with someone special. You like the person and want to go out again, which could be classical conditioning. The food produced a good feeling, and you may associate the person with the food, thus producing a good feeling about the person.

# Attitude

Attitudes are “mental positions” or emotions, favourable or unfavourable evaluations, and action tendencies people have about products, services, companies, ideas, issues, or institutions.<sup>59</sup> Attitudes tend to be enduring, and because they are based on people’s values and beliefs, they are hard to change. Companies want people to have positive feelings about their offerings. A few years ago, KFC began running ads to the effect that fried chicken was healthy, until the U.S. Federal Trade Commission told the company to stop. Wendy’s slogan that its products are “way better than fast food” is another example. Fast food has a negative connotation, so Wendy’s is trying to get consumers to think about its offerings as being better.

An example of a shift in consumers’ attitudes occurred when the taxpayer-paid government bailouts of big banks that began in 2008 provoked the wrath of Americans, creating an opportunity for small banks not involved in the credit bailout and subprime mortgage mess. The Worthington National Bank, a small bank in Fort Worth, Texas, ran billboards reading: “Did Your Bank Take a Bailout? We didn’t.” Another read: “Just Say NO to Bailout Banks. Bank Responsibly!” The Worthington Bank received tens of millions in new deposits soon after running these campaigns (Mantone, 2009).

## Societal Factors

Situational factors, personal factors, and psychological factors influence what you buy, but only temporarily. Societal factors are different as they are more outward and have broad influences on your beliefs and the way you do things. They depend on the world around you and how it works.



# Culture

Culture refers to the shared beliefs, customs, behaviours, and attitudes that characterize a society, and can influence on a consumer's behaviour. Your culture prescribes how you should live and has a huge effect on the things you purchase. For example, in Beirut, Lebanon, women can often be seen wearing miniskirts. If you are a woman in Afghanistan wearing a miniskirt, however, you could face bodily harm or death. In Afghanistan women generally wear *burqas*, which cover them completely from head to toe. Similarly, in Saudi Arabia, women must wear what is called an *abaya*, or long black garment. Interestingly, abayas have become big business in recent years. They come in many styles, cuts, and fabrics and some are encrusted with jewels and cost thousands of dollars. To read about the fashion's women in Muslim countries wear, check out the following article: [time.com](http://time.com).

Even cultures that share many of the same values as the United States can be quite different. Following the meltdown of the financial markets in 2008, countries around the world were pressed by the United States to engage in deficit spending to stimulate the worldwide economy. The plan was a hard sell both to German politicians and to the German people in general. Most Germans do not own credit cards and running up a lot of debt is something people in that culture rarely do. Credit card companies such as Visa, American Express, and MasterCard must understand cultural perceptions about credit.

## Subcultures

A subculture is a group of people within a culture who differ from the dominant culture but have something in

common with one another such as common interests, vocations or jobs, religions, ethnic backgrounds, and geographic locations. The fastest growing subculture in the United States comprises people of Hispanic origin, followed by Asian Americans, and African Americans. The purchasing power of U.S. Hispanics continues to grow, exceeding \$1 trillion in 2010.<sup>60</sup> Home Depot has launched a Spanish version of its Web site. Walmart is converting some of its Neighbourhood Markets into stores designed to appeal to Hispanics. The Supermercado de Walmart stores are in Hispanic neighbourhoods and feature elements such as cafés serving Latino pastries and coffee and full meat and fish counters (Birchall, 2009). Marketing products based on the ethnicity of consumers is useful but may become harder to do in the future because the boundaries between ethnic groups are blurring.

Subcultures, such as college students, can develop in response to people's interests, similarities, and behaviours that allow marketing professionals to design specific products for them. You have probably heard of the hip-hop subculture, people who engage in extreme types of sports such as helicopter skiing or people who play the fantasy game Dungeons and Dragons.

## Social Class

A social class is a group of people who have the same social, economic, or educational status in society.<sup>61</sup> While income helps define social class, the primary variable determining social class is occupation. To some degree, consumers in the same social class exhibit similar purchasing behaviour. In many countries, people are expected to marry within their own social class. When asked, people tend to say they are middle class, which is not always correct. Have you ever been surprised to find out that someone you knew who

was wealthy drove a beat-up old car or wore old clothes and shoes or that someone who isn't wealthy owns a Mercedes or other upscale vehicle? While some products may appeal to people in a social class, you cannot assume a person is in a certain social class because they either have or don't have certain products or brands.

Figure 2. Example of American Social Classifications in the Auto Industry



SOURCES: [Pexels.com](https://www.pexels.com).

The figure above shows an example of social classifications according to automobile purchasing in America. Keep in mind that the U.S. market is just a fraction of the world market. The rise of the middle class in India and China is creating opportunities for many companies to sustain their products. For example, China has overtaken the United States as the world's largest auto market.<sup>62</sup>

In a recession when luxury buyers are harder to come by, the makers of upscale brands may want their customer bases to be as large as possible. However, companies do not want to risk "cheapening" their brands. That is why, for example, Smart Cars, which are made by BMW, do not have the BMW label on them. For a time, Tiffany's sold a cheaper line of silver jewellery to a lot of customers. However, the company later worried that its reputation was being tarnished by the line. Keep in mind that a product's price is to some extent

determined by supply and demand. Luxury brands therefore try to keep the supply of their products in check, so their prices remain high.



SOURCE: [KRiemer](#).

The whiskey brand Johnnie Walker has expanded its market share without cheapening the brand by producing a few lower-priced versions of the whiskey and putting them in bottles with different labels.

Some companies, such as Johnnie Walker, have captured market share by introducing “lower echelon” brands without damaging their luxury brands. The company’s whiskeys come in bottles with red, green, blue, black, and gold labels. The Blue Label is the company’s “best” product, with a serial number and sold in a silk-lined box, accompanied by a certificate of authenticity.<sup>63</sup>

## Reference Groups and Opinion Leaders

Reference groups are groups (social groups, work groups, family, or close friends) a consumer identifies with and

may want to join. They influence consumers' attitudes and behaviour. If you have ever dreamed of being a professional player of basketball or another sport, you have an aspirational reference group. That is why, for example, Nike hires celebrities such as Michael Jordan to pitch the company's products. There may also be dissociative groups or groups where a consumer does not want to be associated.

Opinion leaders are people with expertise in certain areas. Consumers respect these people and often ask their opinions before they buy goods and services. An information technology (IT) specialist with a great deal of knowledge about computer brands is an example. These people's purchases often lie at the forefront of leading trends. The IT specialist is probably a person who has the latest and greatest tech products, and his opinion of them is likely to carry more weight with you than any sort of advertisement.

Today's companies are using different techniques to reach opinion leaders. Network analysis using special software is one way of doing so. Orgnet.com has developed software for this purpose. Orgnet's software does not mine sites like Facebook and LinkedIn, though. Instead, it is based on sophisticated techniques that unearthed the links between Al Qaeda terrorists. Explains Valdis Krebs, the company's founder:

*"Pharmaceutical firms want to identify who the key opinion leaders are. They do not want to sell a new drug to everyone. They want to sell to the 60 key oncologists" (Campbell, 2004).*

## Family

Most market researchers consider a person's family to be one of the most important influences on their buying behaviour. Like it or not, you are more like your parents than you think, at least in terms of your consumption patterns. Many

of the things you buy and do not buy result from what your parents bought when you were growing up. Products such as the brand of soap and toothpaste your parents bought and used, and even the “brand” of politics they leaned toward (Democratic or Republican) are examples of the products you may favour as an adult.

Companies are interested in which family members have the most influence over certain purchases. Children have a great deal of influence over many household purchases. For example, in 2003 nearly half (47%) of 9- to 17-year-olds were asked by parents to go online to find out about products or services, compared to 37% in 2001. IKEA used this knowledge to design their showrooms. The children’s bedrooms feature fun beds with appealing comforters to prompt children to identify and ask for what they want.<sup>64</sup>

Marketing to children has come under increasing scrutiny. Some critics accuse companies of deliberately manipulating children to nag their parents for products. For example, even though tickets for Hannah Montana concerts ranged from hundreds to thousands of dollars, the concerts often still sold out. As one writer put it, exploiting “pester power” is not always ultimately in the long-term interests of advertisers if it alienates kids’ parents (Waddell, 2009).



SOURCE: [Poswiecie.](#)

### *Key Takeaways*

Situational influences are temporary conditions that affect how buyers behave. They include physical factors such as a store's buying locations, layout, music, lighting, and even scent. Companies try to make the physical factors in which consumers shop as favourable as possible. If they cannot, they use other tactics such as discounts. The consumer's social situation, time factors, the reason for their purchases, and their moods also affect their buying behaviour.

Your personality describes your disposition as other people see it. Market researchers believe people buy products to enhance how they feel about

themselves. Your gender also affects what you buy and how you shop. Women shop differently than men. There is some evidence that this is changing. Younger men and women are shopping more alike. People buy different things based on their ages and life stages. A person's cognitive age is how old one "feels" oneself to be. To further understand consumers and connect with them, companies have looked more closely at their lifestyles (what they do, how they spend their time, what their priorities and values are, and how they see the world).

Psychologist Abraham Maslow theorized people must fulfill their basic needs, like the need for food, water, and sleep, before they can begin fulfilling higher level needs. Perception is how you interpret the world around you and make sense of it in your brain. To be sure their advertising messages get through to you, companies often resort to repetition. Shocking advertising and product placement are two other methods. Learning is the process by which consumers change their behaviour after they gain information about or experience with a product. Consumers' attitudes are the "mental positions" people take based on their values and beliefs. Attitudes tend to be enduring and are often difficult for companies to change.

Culture prescribes how you should live and affects the things you purchase. Consumers in the same social class exhibit similar purchasing behaviour. Most market researchers consider a person's family to be one of the biggest determinants of buying behaviour. Reference groups are groups that a consumer identifies



with and wants to join. Companies often hire celebrities to endorse their products to appeal to people's reference groups. Opinion leaders are people with expertise in certain areas. Consumers respect these people and often ask their opinions before they buy goods and services.

### *Exercises*

Explain what physical factors, social situations, time factors, and/or moods have affected your buying behaviour for different products.

Explain how someone's personality differs from his or her self-concept. How does the person's ideal self-concept come into play in a consumer behaviour context?

Describe how buying patterns and purchase decisions may vary by age, gender, and stage of life.

Why are companies interested in consumers' cognitive ages and lifestyle factors?

How does the process of perception work, and how can companies use it to their advantage in their marketing?

How do Maslow's hierarchy of needs and learning affect how companies market to consumers?

Why do people's cultures and subcultures affect what they buy?

How do subcultures differ from cultures? Can you belong to over one culture or subculture?

How are companies trying to reach opinion leaders?

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# 7/ Launching Business

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SOURCE: [Markus Spiske](#).

## Launching Your Business

*Learning Objectives*

- Understand the branding decisions firms make when they're developing new products.
- Identify the various levels of packaging for new products.

## Branding, Labelling, and Packaging

What comes to mind when someone says Coke or Nike or Microsoft? According to *BusinessWeek* magazine, the Coca-Cola brand is the *strongest* brand in the world. However, a global study of consumers sponsored by Reuters found Apple has the *best* brand. What is a “brand” and what do these studies mean when they report that one brand is the strongest or the best?

### Branding

We have mentioned brands periodically throughout this chapter. But what is a brand? A brand is a name, picture, design, or symbol, or combination of those items, used by a seller to identify its offerings and to differentiate them from competitors' offerings. Branding is the set of activities designed to create a brand and position it in the minds of consumers. Did you know The Beatles started a recording studio called Apple? When Apple Computer (the iPod company) was formed, Apple Corp., Ltd. (the Beatles' recording studio), sued Apple Computer because two companies with the same name can create confusion among consumers. This was not much of a problem when Apple was only selling

computers but following the release of the iPod and launch of Apple's iTunes program, the companies' offerings are similar enough for consumers to confuse the two companies and their products. In fact, it was not until recently that they settled the lawsuit over the name, some 30 years after they filed the initial lawsuit. The situation signifies how important brand names are to the companies that own them.

A successful branding strategy is one that accomplishes what Coke and Apple have done, it creates consumer recognition of what the brand (signified by its name, picture, design, symbol, and so forth) means. When marketing professionals are considering whether a potential new offering fits a company's image, they are very concerned about whether the offering supports the organization's brand and position in the consumer's mind. For this reason, many consider branding to be much more than how the product is packaged or labelled, and they are right. Characteristics of the offering, such as pricing and quality, must support the brand's position. If Apple (the brand) stands for innovation, then products and services must be innovative. But branding itself refers to strategies that create an image and position in the consumers' minds.

A brand name, like Apple, is the spoken part of a brand's identity. A brand mark is the symbol, such as Coke's wave or Apple Computer's multicolor apple (not to be confused with Apple Records' green apple), associated with a brand. Brand names and brand marks are important to companies because consumers use them to make choices. That is why it was important to sort out the Apple brand. Each company wanted to make sure that consumers were getting what they wanted and would know what each brand meant.

An important decision companies must make is under which brand they will market a new offering. For example, Black & Decker makes power tools for consumers under its Black & Decker brand, while tools for more serious do-it-

yourself and professionals are under its DeWalt brand. If Black & Decker added to its DeWalt line new products such as coolers, portable radios, CD players, and other accessories construction professionals might find useful at a job site, the company would create a brand extension. A brand extension involves using an existing brand name or mark for a new product category.



SOURCE: [Pixabay](#).

Why would Black & Decker add these accessories to the DeWalt line? If the company did, it would be because DeWalt already has an excellent reputation for high-quality, long-lasting durability, and performance among construction professionals. These same professionals would trust the DeWalt brand to deliver. How a company like Black & Decker goes about building this trust is the subject of later chapters. For now, let us consider whether it is better for a company to market a new product via a brand extension or create an entirely new brand for the product.

Firms should consider when branding a new offering that they are not cannibalizing their other products. Cannibalization occurs when a firm's new offering eats into

the sales of one of its older offerings. (Ideally, when you sell a new product, you hope that all its sales come from your competitors' buyers or buyers that are new to the market.) A completely new offering will not result in cannibalization, whereas a line extension likely will. A brand extension will also result in some cannibalization if you sell similar products under another brand. For example, if Black & Decker already had an existing line of coolers, portable radios, and CD players when the DeWalt line launched, the new DeWalt offerings might cannibalize some of the Black & Decker offerings. Some marketers argue that cannibalization can be a good thing because it is a sign that a company is developing new and better offerings. These people believe that if you do not cannibalize your own line, then your competitors will.

## **Packaging Decisions**

Another set of questions to consider involves the packaging on which a brand's marks and name will be prominently displayed. Sometimes the package itself is part of the brand. For example, the curvaceous shape of Coca-Cola's Coke bottle is a registered trademark. If you decide to market in a similar-shaped bottle, Coca-Cola's attorneys will have grounds to sue you.





SOURCE: [alleksana](#).

Sometimes the package itself is part of a licensed brand. Coke's curvaceous bottle is an example. Packaging must fulfill several important functions, including communicating the brand and its benefits; protecting the product from damage and contamination during shipment, as well as damage and tampering once it is in retail outlets; preventing leakage of the contents; presenting government-required warning and information labels.

Sometimes packaging can fulfill other functions, such as serving as part of an in-store display designed to promote the offering. A single wholesale unit of a product, such as these empty cartons shown here, is an example of secondary packaging. Each of these boxes might hold, for example, 24 cans of car polish or 36 cans of bug spray.



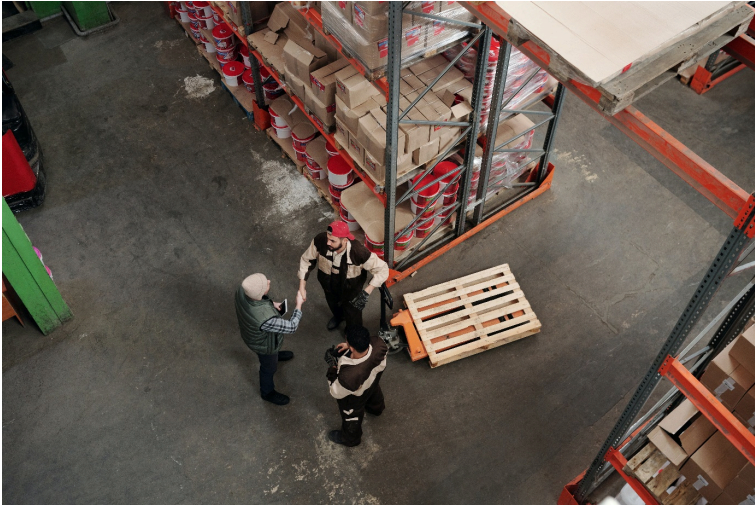
SOURCE: [Norma Mortenson](#).

Primary packaging holds a single retail unit of a product. For example, a bottle of Coke, a bag of M&Ms, or a ream of printer paper (500 sheets) are all examples of primary packages. Primary packaging can protect and promote products and get the attention of consumers. Primary packaging can also demonstrate the proper use of an offering, provide instructions on how to assemble the product, or any other needed information. If warning or nutrition labels are required, they must be on the primary packaging. Primary packaging can be bundled together as well. Consumers can buy bottles of Coke sold in six-packs or cans of Coke in 12-packs, for example.

Secondary packaging holds a single wholesale unit of a product. A case of M&M bags is an example, as are cartons of reams of paper. Secondary packaging is designed more for retailers than consumers. It does not have to carry warning or nutrition labels but is still likely to have brand marks and labels. Secondary packaging further protects the individual products during shipping.

Tertiary packaging is packaging designed specifically

for shipping and efficiently handling large quantities. When a Coca-Cola bottler ships cases of Cokes to a grocery store, they are stacked on pallets (wooden platforms) and then wrapped in plastic. Pallets can be easily moved by a forklift truck and can even be moved within the grocery store by a small forklift. This product is bound in tertiary packaging so that mass quantities of it can be stacked on pallets and moved with a forklift.



SOURCE: [Tiger Lily](#).

A product's packaging can benefit the customer beyond just protecting the offering while it is being shipped. No-spill caps, for example, can make it easier for you to use your laundry detergent or prevent spills when you are adding oil to your car's engine. And, as we have noted, secondary packaging (and tertiary packaging) can serve as part of an in-store display, adding value for your retailers.

*Key Takeaways*

A brand is a name, picture, design, or symbol, or combination of those items, used by a seller to identify its offerings and differentiate them from competitors' offerings. Branding is the set of activities designed to create a brand and position it relative to competing brands in the minds of consumers. An important decision companies must make is under which brand they will market a new offering. A brand extension involves using an existing brand name or brand mark for a new product or category (line) of products. Cannibalization occurs when a company's new offering eats into the sales of one of its older offerings. It is something to be avoided in most cases, but it can also be a sign of progress because it means a company is developing new and better products. Packaging protects products from damage, contamination, leakage, and tampering, but it is also used to communicate the brand and its benefits, product warnings, and proper use.

### *Exercises*

How do brands help companies market their products?

What is the purpose of a brand extension?

Name the basic packaging used in marketing.

# Managing New Products



SOURCE: [Laryssa](#).

## *Learning Objectives*

- Explain how organizations manage offerings after being introduced.
- Explain how an offering may be different in international markets.
- Explain the product life cycle, objectives, and strategies for each stage.

# The Product Life Cycle

Over 20,000 new offerings, including convenience foods, health and beauty aids, electronics, automobiles, pharmaceutical products, hotels, restaurants, and so on, enter the marketplace each year. For example, in 2006 almost 1,400 food products making a “whole grain claim” were introduced (Roskelly, 2010). Other recent new product introductions include many technological products such as Nintendo’s Wii, iPhones, and digital video recorders (DVRs); many new personal care products such as new fragrances of shampoo and conditioner and new flavours of toothpaste; and new convenience foods such as frozen meals, “100-calorie pack” snacks, and cereal bars (Hunter, 2008).

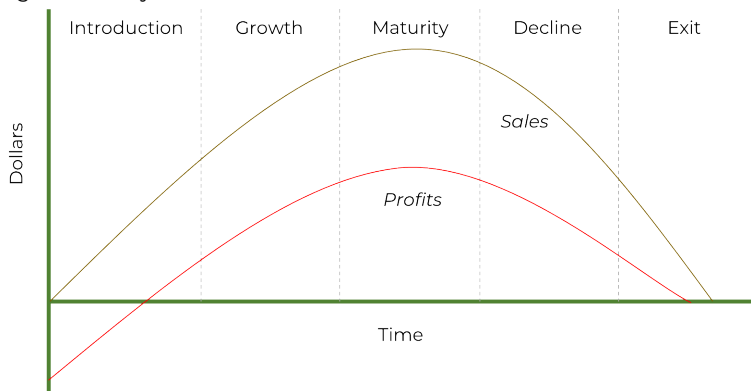
Once a product is created and introduced in the marketplace, the offering must be managed effectively for the customer to receive value from it. Only if this is done will the product’s producer achieve its profit objectives and be able to sustain the offering in the marketplace. The process involves making many complex decisions, especially if the product is being introduced in global markets. Before introducing products in global markets, an organization must evaluate and understand factors in the external environment, including laws and regulations, the economy, and stage of economic development, the competitors, and substitutes, cultural values, and market needs. Companies also need expertise to launch products in foreign markets. Given many constraints in international markets, companies might initially introduce a product in limited areas abroad. Other organizations, such as Coca-Cola, decide to compete in markets worldwide.<sup>65</sup>

The product life cycle (PLC) includes the stages the product goes through after development, from introduction to the end of the product. Just as children go through different phases in life (toddler, elementary school, adolescent, young adult, and so on), products and services also age and go

through different stages. The PLC is a beneficial tool that helps marketers manage the stages of a product's acceptance and success in the marketplace, beginning with the product's introduction, its growth in market share, maturity, and decline in market share. Other tools such as the [Boston Consulting Group matrix](#) and the General Electric approach may also manage and decide about what to do with products. For example, when a market is no longer growing but the product is doing well (cash cow in the BCG approach), the company may decide to use the money from the cash cow to invest in other products they have rather than continuing to invest in the product in a no-growth market.

The product life cycle can vary for different products and different product categories. The figure below "Life Cycle" illustrates an example of the product life cycle, showing how a product can move through four stages. However, not all products go through all stages and the length of a stage varies. For example, some products never experience market share growth and are withdrawn from the market.

Figure 1. Life Cycle



Other products stay in one stage longer than others. For example, in 1992, PepsiCo introduced a product called Clear Pepsi, which went from introduction to decline rapidly. Diet Coke entered the growth market soon after its introduction in

the early 1980s and then entered (and remains in) the mature stage of the product life cycle. New computer products and software and video games often have limited life cycles, whereas product categories such as diamonds and durable goods (kitchen appliances) generally have longer life cycles. How a product is promoted, priced, distributed, or changed can also vary throughout its life cycle. Let us now look at the various product life cycle stages and what characterizes each.

## **The Introduction Stage**

The first stage in a product's life cycle is the introduction stage. The introduction stage is the same as commercialization, or the last stage of the new product development process. Marketing costs are typically higher in this stage than in other stages. As an analogy, think about the amount of fuel a plane needs for takeoff relative to the amount it needs while in the air. Just as an airplane needs more fuel for takeoff, a new product, or service needs more funds for introduction into the marketplace. Communication (promotion) is needed to generate awareness of the product and persuade consumers to try it, and placement alternatives and supply chains are needed to deliver the product to the customers. Profits are often low in the introductory stage because of the research and development costs and the marketing costs necessary to launch the product.

The length of the introductory stage varies for different products. However, by law in the United States, a company is only allowed to use the label "new" on a product's package for six months. An organization's objectives during the introductory stage often involve educating potential customers about its value and benefits, creating awareness, and getting potential customers to try the product or service. Getting products and services, particularly multinational



brands, accepted in foreign markets can take even longer. Companies introducing products and services abroad generally must have the financial resources to make a long-term (longer than a year) commitment to their success.

The specific promotional strategies a company uses to launch a product vary depending on the type of product and the number of competitors it faces in the market. Firms that manufacture products such as cereals, snacks, toothpastes, soap, and shampoos often use mass marketing techniques such as television commercials and Internet campaigns and promotional programs such as coupons and sampling to reach consumers. To reach wholesalers and retailers such as Walmart, Target, and grocery stores, firms use personal selling. Many firms promote to customers, retailers, and wholesalers. Sometimes other, more targeted advertising strategies are employed, such as billboards and transit signs (signs on buses, taxis, subways, and so on). For more technical or expensive products such as computers or plasma televisions, many firms use professional selling, informational promotions, and in-store demonstrations so consumers can see how the products work.



SOURCE: [Polina Tankilevitch](#).

During introduction, an organization must have enough distribution outlets (places where the product is sold, or the service is available) to get the product or service to the customers. The product quantities must also be available to meet demand. For example, IBM's ThinkPad was a big hit when it was first introduced, but the demand for it was so great that IBM could not produce enough of the product. Cooperation from a company's supply chain members, its manufacturers, wholesalers, and so forth, helps ensure that supply meets demand, and that value is added throughout the process.

When you were growing up, you may remember eating Rice Krispies Treats cereal, a very popular product. The product was so popular that Kellogg's could not keep up with initial demand and placed ads to consumers apologizing for the problem. When demand is higher than supply, the door opens for competitors to enter the market, which is what happened when the microwave was introduced. Most people own a microwave, and prices have dropped significantly since Amana introduced the first microwave at a price of almost \$500. As consumers in the United States initially saw and heard about the product, sales increased from 40,000 units to over a million units in only a few years. Sales in Japan increased even more rapidly because of a lower price. Because of the high demand in both countries, many competitors entered the market and prices dropped.<sup>66</sup>

Product pricing strategies in the introductory stage can vary depending on the type of product, competing products, the extra value the product provides consumers versus existing offerings, and the costs of developing and producing the product. Organizations want consumers to perceive that a new offering is better or more desirable than existing products. Two strategies that are widely used in the introductory stage are penetration pricing and skimming. A penetration pricing strategy involves using a low initial price to encourage many customers to try a product. The organization

hopes to sell a high volume to generate substantial revenues. New varieties of cereals, fragrances of shampoo, scents of detergents, and snack foods are often introduced at low initial prices. Seldom does a company use a high price strategy with a product such as this. The low initial price of the product is often combined with advertising, coupons, samples, or other special incentives to increase awareness of the product and get consumers to try it.

A company uses a skimming pricing strategy, which involves setting a high initial price for a product, to more quickly recoup the investment related to its development and marketing. The skimming strategy attracts the top, or high-end, of the market. This market comprises customers who are not as price sensitive or who are early adopters of products. Firms that produce electronic products such as DVRs, plasma televisions, and digital cameras set their prices high in the introductory stage. However, the high price must be consistent with the product and the other marketing strategies being used to promote it. For example, engaging in more personal selling to customers, running ads targeting specific groups of customers, and placing the product in a few distribution outlets are likely to be strategies firms use with a skimming approach.

## **The Growth Stage**

If a product is accepted by the marketplace, it enters the growth stage of the product life cycle. The growth stage is characterized by increasing sales, more competitors, and higher profits. Unfortunately for the firm, the growth stage attracts competitors who enter the market quickly. For example, when Diet Coke experienced outstanding success, Pepsi soon entered with Diet Pepsi. You notice that both Coca-Cola and Pepsi have similar competitive offerings in the

beverage industry, including their own brands of bottled water, juice, and sports drinks. As additional customers buy the product, manufacturers must ensure that the product remains available to customers or risk them buying competitors' offerings. For example, the producers of video game systems such as Nintendo's Wii could not keep up with consumer demand when the product was first launched. Some consumers purchased competing game systems such as Microsoft's Xbox.



SOURCE: [Stas Knop](#).

A company sometimes increases its promotional spending on a product during its growth stage. Instead of encouraging consumers to try the product, the promotions focus on the specific benefits it offers and values relative to competitors. Although the company must still inform and educate customers, it must counter the competition. Emphasizing the advantages of the product's brand name can help a company maintain its sales in the face of competition. Although different organizations produce personal computers, a highly recognized brand such as IBM strengthens a firm's advantage when competitors enter the market. New offerings that use the same successful brand name as a company's

existing offerings, which is what Black & Decker does with some of its products, can give a company a competitive advantage. Companies typically make a profit during the growth stage because more units are being sold.

The number of distribution outlets (stores and dealers) used to sell the product can also increase during the growth stage as a company tries to reach as much of the marketplace as possible. Expanding a product's distribution and increasing its production to ensure its availability at different outlets usually results in a product's costs remaining high during the growth stage. The price of the product itself typically remains at about the same level during the growth stage, although some companies reduce their prices slightly to attract additional buyers and meet the competitors' prices. Companies hope by increasing their sales, they also improve their profits.

## **The Maturity Stage**

After many competitors enter the market and the number of potential new customers declines, the sales of a product typically level off. This shows that a product has entered the maturity stage of its life cycle. Most consumer products are in the mature stage of their life cycle; their buyers are repeat purchasers versus new customers. Intense competition causes profits to fall until only the strongest players remain. The maturity stage lasts longer than other stages. Quaker Oats and Ivory Soap are products in the maturity stage, they have been on the market for over 100 years.

Given the competitive environment in the maturity stage, many products are promoted heavily to consumers by stronger competitors. The strategies used to promote the products often focus on value and benefits that give the

offering a competitive advantage. The promotions aimed at a company's distributors may also increase during the mature stage. Companies may decrease the price of mature products to counter the competition. However, they must be careful not to get into "price wars" with their competitors and destroy all the profit potential of their markets, threatening a firm's survival. Intel and Advanced Micro Devices (AMD) have engaged in several price wars about their microprocessors. Likewise, Samsung added features and lowered the price on its Instinct mobile phone, engaging in a price war with Apple's iPhone. With the weakened economy, many online retailers engaged in price wars during the 2008 holiday season by cutting prices on their products and shipping costs; they repeated this price war strategy in 2011. Although large organizations such as Amazon.com can absorb shipping costs, price wars often hurt smaller retailers. Many retailers learned from their mistakes and ordered less inventory for the 2009 holiday season; it remains to be seen what will happen in the 2012 holiday season.

Companies are challenged to develop strategies to extend the maturity stage of their products, so they remain competitive. Many firms do so by modifying their target markets, their offerings, or their marketing strategies. Next, we look at each of these strategies.

Changing the target market helps a company attract different customers by seeking new users, going after different market segments, or finding new uses for a product to attract additional customers. Financial institutions and automobile dealers realized that women have increased buying power and now market for them. With the growth in the number of online shoppers, more organizations sell their products and services through the Internet. Entering new markets provides companies an opportunity to extend the product life cycles of their different offerings.



SOURCE: [Stefan Stefancik](#).

Many companies enter different geographic markets or international markets as a strategy to get new users. A product that might be in the mature stage in one country might be in the introductory stage in another market. For example, when the U.S. market became saturated, McDonald's began opening restaurants in foreign markets. Cell phones were very popular in Asia before they were introduced in the United States. Many cell phones in Asia are being used to scan coupons and to charge purchases. However, the market in the United States might not be ready for that type of technology.

Changing the product, such as changing its packaging, size, flavours, colours, or quality can also extend the product's maturity stage. The 100-Calorie Packs created by Nabisco provide an example of how a company changed the packaging and size to provide convenience and 100-calorie portions for consumers. While the sales of many packaged foods fell, the sales of the 100-Calorie Packs increased to over \$200 million, prompting Nabisco to repackage more products (Hunter, 2008). Kraft Foods extended the mature stage of different crackers such as Wheat Thins and Triscuits by creating

different flavours. Although not popular with consumers, many companies downsize (or decrease) the package sizes of their products or the amount of the product in the packages to save money and keep prices from rising too much.



SOURCE: [Gabriel Freytez](#).

Car manufacturers modify their vehicles slightly each year to offer new styles and additional safety features. Every three to five years, automobile manufacturers do more extensive modifications. Changing the package or adding variations or features are common ways to extend the mature stage of the lifecycle. Pepsi recently changed the design and packaging of its soft drinks and Tropicana juice products. However, consumers thought the new juice package looked like a less expensive brand, which made the quality of the product look poorer. As a result, Pepsi resumed the use of the original Tropicana carton. Pepsi's redesigned soda cans also received negative consumer reviews.

Video 1. How to Successfully Rebrand Your Company | Inc.





*A YouTube element has been excluded from this version of the text. You can view it online here:*

<https://pressbooks.library.upei.ca/startup/?p=518>

#### ([Video Link](#))

When introducing products to international markets, firms must decide if the product can be standardized (kept the same) or how much adaptation, or changing, of the product to meet the needs of the local culture is necessary. Although it is much less expensive to standardize products and promotional strategies, cultural and environmental differences usually require some adaptation. Product colours and packages and product names must often be changed because of cultural and legal differences. For example, in many Asian and European countries, Coca-Cola's diet drinks are called "light," not diet, because of legal restrictions on how the word diet can be used. GE makes smaller appliances such as washers and dryers for the Japanese market because houses are smaller and do not have the room for larger models. Hyundai Motor Company had

to improve the quality of its automobiles to compete in the U.S. market. Companies must also examine the external environment in foreign markets since the regulations, competition, and economic conditions vary as well as the cultures.

Some companies change their marketing strategy for one or more marketing variables of their products. For example, many coffee shops and fast food restaurants such as McDonald's now offer specialty coffee that competes with Starbucks. As a result, Starbucks' managers decided it was time to change the company's strategy. Over the years, Starbucks had added lunch offerings and moved away from grinding coffee in the stores to provide faster service for its customers. However, customers missed the coffee shop atmosphere and the aroma of freshly brewed coffee and did not like the smell of all the lunch items.



SOURCE: [Ade Rifaie](#).

Starbucks' former CEO and founder Howard Schultz returned to the company because of the falling market share. Schultz hired consultants to determine how to change the firm's offering and extend the maturity stage of their life cycle. Subsequently, Starbucks changed the atmosphere of many of

its stores back to that of traditional coffee shops, changed its lunch offerings in many stores, and resumed grinding coffee in stores to provide the aroma customers missed. The company also changed some of its offerings to provide health-conscious consumers lower-calorie alternatives (Horovitz, 2008). After the U.S. economy weakened in 2009, Starbucks announced it would begin selling instant coffee for about a dollar a cup to appeal to customers who were struggling financially but still wanted a special cup of coffee. The firm also changed its communication by utilizing more interactive media such as blogs.

Unlike the over-extension by Starbucks, McDonald's plans to add 14,000 coffee bars to selected stores.<sup>67</sup> Besides the coffee bars, many McDonald's stores are remodelling their interiors to feature flat screen televisions, recessed lighting, and wireless Internet access. Other McDonald's restaurants kept their original design, which customers still like.



SOURCE: [Mjr293](#).

## The Decline Stage

When sales decrease and continue to drop to lower levels, the product has entered the decline stage of the product life cycle. In the decline stage, changes in consumer preferences, technological advances, and alternatives that satisfy the same need can lead to a decrease in demand for a product. How many of your fellow students do you think have used a typewriter, adding machine, or slide rule? Computers replaced the typewriter and calculators replaced adding machines and the slide rule. Ask your parents about eight-track tapes, which were popular before cassette tapes, which were popular before CDs, which were popular before MP3 players and Internet radio. Some products decline slowly. Others go through a rapid level of decline. Many fads and fashions for young people have very short life cycles and go “out of style” quickly. If you have ever asked your parents to borrow clothes from the 1990s, you may be amused at how much the styles have changed. Similarly, many students do not have landline phones or VCR players and cannot believe that people still use the “outdated” devices. Some outdated devices, like payphones, disappear almost completely as they become obsolete.

Technical products such as digital cameras, cell phones, and video games that appeal to young people often have limited life cycles. Companies must decide what strategies to take when their products enter the decline stage. To save money, some companies try to reduce their promotional expenditures on these products and the number of distribution outlets in which they are sold. They might implement price cuts to get customers to buy the product. Harvesting the product entails gradually reducing all costs spent on it, including investments made in the product and marketing costs. By reducing these costs, the company hopes that the profits from the product will increase until their

inventory runs out. Another option for the company is divesting (dropping or deleting) the product from its offerings. The company might choose to sell the brand to another firm or simply reduce the price drastically to get rid of all remaining inventory. If a company keeps the product, it may lose money or make money if competitors drop out. Many companies decide the best strategy is to modify the product in the maturity stage to avoid entering the decline stage.

## The Exit Stage

If a company cannot liquidate their remaining stock, they might end up stuck with it. According to the [Copenhagen Fashion Summit](#), 92 million tonnes of solid waste is dumped into landfills each year (Davis, 2019). Grocery stores in the United States throw away 33.3% of food it produces ([133 billion pounds of food](#)) because of overstocked product displays; expectation of perfection (quality); sell-by dates; damaged goods and unpopular items (Jacobs, 2014). Walgreens, donates 5 million pounds of food to charity (see: [Marketplace.org](#) for a full article on what do stores do with unsold merchandise?). Business owners face the challenge of understanding their customers to reduce wastage, and consumers are challenged to reduce unnecessary materialism.



SOURCE: [Tom Fisk](#).

Table 1. Strategies for Success at Each Stage of the Product Life Cycle

	Introduction	Growth	Maturity	Decline
Marketing objectives	Encourage trial, establish distribution	Get triers to repurchase, attract new users	Seek new user or users	Reduce marketing expenses, used to keep loyal users
Product	Establish competitive advantage	Maintain product quality	Modify product	Maintain product
Distribution	Establish distribution network	Solidify distribution relationships	Provide additional incentives to ensure support	Eliminate trade allowances
Promotional	Build brand awareness	Provide information	Reposition product	Eliminate most advertising and sales promotions
Pricing	Set introductory price (skimming or penetration pricing)	Maintain prices	Reduce prices to meet competition	Maintain prices

SOURCE: [Introduction to Business](#) by Rice University under [Creative Commons Attribution 4.0 International License](#), except where noted.

### *Key Takeaways*

The product life cycle helps a company understand the stages (introduction, growth, maturity, and decline) a product or service may go through once it is launched in the marketplace. The number and length of stages can vary. When a product is launched or commercialized, it enters the introduction stage. Companies must try to generate awareness of the product and encourage consumers to try it. During the growth stage, companies must show the product's benefits and value to persuade customers to buy it versus competing products. Some products never experience growth. Many products are in the mature stage. In the mature stage, sales level off and the market typically have many competitors. Companies change the target market, the offering, or the marketing mix to extend the mature stage and keep from going into decline. If a product goes into decline, a company must decide whether to keep the product, harvest and reduce the spending on it until all the inventory is sold, or divest and get rid of the product.

### *Exercises*

Explain what a firm that sells a product with a limited life cycle (such as software) should do in each stage, so there is not a lot of inventory left over when a newer version is introduced?

Explain why the marketing costs related to a product are typically higher during the introduction stage and why companies must generate awareness of the new product or service and encourage consumers to try it.

Explain why and when penetration and skimming pricing are used in the introduction stage.

What stage of the life cycle is a product in when the company cannot meet the demand for it and competitors enter the market?

What different strategies do firms use to extend the life cycles of their products throughout the maturity stage?

How did Kraft extend the mature stage of the product life cycle of Wheat Thins crackers?

Explain the difference between harvesting and a divesting when a firm enters the decline stage.

## Footnotes

<sup>65</sup> “Best Global Brands,” *Interbrand*, 2009, [http://www.interbrand.com/best\\_global\\_brands.aspx?langid=1000](http://www.interbrand.com/best_global_brands.aspx?langid=1000) (accessed January 20, 2010).

<sup>66</sup> “Microwave Oven,” *Wikipedia*, <http://en.wikipedia.org/wiki/>



Microwave\_oven (accessed January 20, 2010).

<sup>67</sup> “Starbucks v McDonald’s,” *Economist*, January 10, 2008, [http://www.economist.com/business/displaystory.cfm?story\\_id=10498747](http://www.economist.com/business/displaystory.cfm?story_id=10498747) (accessed January 20, 2010).

# 8/ Business Operations

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Source: [Alexander](#).

## *Learning Objectives*

- What is the general environment and why is it

important to organizations?

- What are the features of Porter's five forces industry analysis?
- What are strategic groups and how are they useful to evaluating the environment?

## Evaluating the External Environment

Many observers were stunned in March 2011 when news broke that Subway had surpassed McDonald's as the biggest restaurant chain in the world. At the time of the announcement, Subway had 33,749 units under its banner while McDonald's had 32,737 (Kingsley, 2011). Despite its meteoric growth, many opportunities remained. In China, for example, Subway had fewer than 200 stores. In contrast, China hosts over 3,200 Kentucky Fried Chicken stores. Overall, Subway was on a roll, and this success seemed likely to continue.

How had Subway surpassed a global icon like McDonald's? One key factor was Subway's efforts to provide and promote healthy eating options. This emphasis took hold in the late 1990s when the American public became captivated by college student Jared Fogle. As a freshman at Indiana University in 1998, the 425-pound Fogle tried to lose weight by walking regularly and eating a Subway diet. Amazingly, Fogle dropped 245 pounds by February 1999.

Subway executives knew that a great story had fallen into their laps. They featured Fogle in Subway's advertising and soon he was a well-known celebrity. In 2007, Fogle met with President Bush about nutrition and testified before the U.S.

Congress about the need for healthier snack options in schools. Today, Fogle is the face of Subway and one of the few celebrities who are instantly recognizable based on his first name alone. Much like Beyonce and Oprah, you can mention “Jared” to almost anyone in America and that person will know exactly of whom you are speaking. Subway’s line of Fresh Fit sandwiches is targeted at prospective Jared’s who want to improve their diets. Although Subway at the time believed the eating health initiative was important, Jared Fogle was sentenced to 15 years imprisonment for trading in child pornography and having sex with underage prostitutes (Callahan, 2015). Since the prosecution of Jared, Subway closed over 1,000 locations and since the pandemic, has pivoted to adding the sale of grocery items to business operations (Olito, 2020).

Because American diets contain too much salt, which can cause high blood pressure, salt levels in restaurant food are attracting increased scrutiny. Subway responded to this issue in April 2011 when its outlets in the United States reduced the amount of salt in all its sandwiches by at least 15% with no alteration in taste (Riley, 2011). The Fresh Fit line of sandwiches received a more dramatic 28% reduction in salt. They enacted these changes after customers of Subway’s outlets in New Zealand and Australia embraced similar adjustments. Although the new sandwich recipes cost slightly more than the old ones, Subway plans to absorb these costs rather than raising their prices. This may be a wise strategy for retaining customers, who have become very price sensitive because of the ongoing uncertainty surrounding the American economy and the high unemployment. For an example of “healthy” fast food options in Canada see [here](#) or [here](#).

# The Organization and its Environment

## *Learning Objectives*

- Define the environment in the context of business.
- Understand how an organization and its environment affect each other.
- Learn the difference between the general environment and the industry.

## What is the Environment?<sup>68</sup>

For any organization, the environment is a set of external conditions and forces that have the potential to influence the organization. With Subway, for example, the environment contains its customers, its rivals such as McDonald's and Kentucky Fried Chicken, social trends such as the shift in society toward healthier eating, political entities such as the U.S. Congress, and many additional conditions and forces.

It is useful to break the concept of the environment down into two components. The general environment (or macro environment) includes overall trends and events in society such as social trends, technological trends, demographics, and economic conditions. The **industry<sup>69</sup> (or competitive environment)** comprises multiple organizations

that collectively compete with one another by providing similar goods, services, or both.

Every action that an organization takes, such as raising its prices or launching an advertising campaign, creates some changes in the world around it. Most organizations are limited to influencing their industry. Subway's move to cut salt in its sandwiches, for example, may lead other fast food firms to revisit the amount of salt in their products. A few organizations wield such power and influence that they can shape some elements of the **general environment**.<sup>70</sup>

While most organizations simply react to major technological trends, for example, the actions of firms such as Intel, Microsoft, and Apple help create these trends. Some aspects of the general environment, such as demographics, simply must be taken as a given by all organizations. Overall, the environment has a far greater influence on most organizations than most organizations have on the environment.

## Why Does the Environment Matter?

Understanding the environment that surrounds an organization is important to the executives in charge of the organizations. There are several reasons for this. First, the environment provides resources that an organization needs to create goods and services. In the 17th century, British poet John Donne famously noted that “no man is an island.” Similarly, it is accurate to say that no organization is self-sufficient. As the human body must consume oxygen, food, and water, an organization needs to take in resources such as labour, money, and raw materials from outside its boundaries. Subway, for example, simply would cease to exist without the contributions of the franchisees that operate its stores, the suppliers that provide food and other necessary inputs, and the customers

who provide Subway with money through purchasing its products. An organization cannot survive without the support of its environment.

Second, the environment is a source of opportunities and threats for an organization. **Opportunities**<sup>71</sup> are events and trends that create chances to improve an organization's performance level. **Threats**<sup>72</sup> are events and trends that may undermine an organizations performance. Subway faces a threat from some upstart restaurant chains. Saladworks, for example, offers a variety of salads that contain fewer than 500 calories. Noodles and Company offers a variety of sandwiches, pasta dishes, and salads that contain fewer than 400 calories. These two firms are much smaller than Subway, but they could grow to become substantial threats to Subway's positioning as a healthy eatery.

Executives must also realize that virtually any environmental trend or event is likely to create opportunities for some organizations and threats for others. This is true even in extreme cases. Besides horrible human death and suffering, the March 2011 earthquake and tsunami in Japan devastated many organizations, ranging from small businesses that were simply wiped out to corporate giants such as Toyota whose manufacturing capabilities were undermined. As odd as it may seem, however, these tragic events also opened up significant opportunities for other organizations. The rebuilding of infrastructure and dwellings requires concrete, steel, and other materials. Japanese concrete manufacturers, steelmakers, and construction companies are likely to be very busy in the years ahead.

Third, the environment shapes the various strategic decisions that executives make as they attempt to lead their organizations to success. The environment often places important constraints on an organization's goals, for example. A firm that sets a goal of increasing annual sales by 50% might struggle to achieve this goal during an economic recession or

if several new competitors enter its business. Environmental conditions also need to be considered when examining whether to do business in a new country, whether to gain another company, and whether to launch an innovative product, to name just a few.

### *Key Takeaways*

An organization's environment is a major consideration. The environment is the source of resources that the organizations need. It provides opportunities and threats, and it influences the various strategic decisions that executives must make.

### *Exercises*

- What are the three reasons that the environment matters?
- Which of these three reasons is most important? Why?
- Can you identify an environmental trend that no organizations can influence?



# Strategy as a Plan

Strategic plans are the essence of strategy, according to one classic view of strategy. A strategic plan is a carefully crafted set of steps that a firm intends to follow to be successful. Virtually every organization creates a strategic plan to guide its future.

While Apple had been a very successful computer company in the early days of the micro computer, by 1996, Apple's performance was not strong, and Gilbert F. Amelio was appointed as CEO (chief executive officer) hoping to reverse the company's fortunes. In a speech focused on strategy, Amelio described a plan that centred on leveraging the Internet (which at the time was in its infancy) and developing multimedia products and services. Apple's subsequent success selling over the Internet via iTunes and with the iPad can be traced back to the plan articulated in 1996 (Markoff, 1996).

A business model should be a central element of a firm's strategic plan. Simply stated, a business model describes the process through which a firm hopes to earn profits. It probably won't surprise you to learn that developing a viable business model requires that a firm sell goods or services for more than it costs the firm to create and distribute those goods. A more subtle but equally important aspect of a business model is providing customers with a good or service more cheaply than they can create it themselves.

Consider, for example, large chains of pizza restaurants such as Boston Pizza and Domino's. Because these firms buy their ingredients in massive quantities, they pay far less for these items than any family could (an advantage called **economies of scale**<sup>73</sup>). Meanwhile, Boston Pizza and Domino's have developed specialized kitchen equipment that allows them to produce better-tasting pizza than can be created using the basic ovens that most families rely on for cooking. Pizza restaurants thus can make better-tasting pizzas for far

less cost than a family can make itself. This business model provides healthy margins and has enabled Boston Pizza and Domino's becoming massive firms.

Strategic plans are important to individuals too. Indeed, a well-known proverb states that "he who fails to plan, plans to fail." Being successful requires a person to define a path for the future and follow it. If you are reading this, earning a college degree is probably a key step in your strategic plan for your career. Do not be concerned if your plan is not fully developed. Life is full of unexpected twists and turns, so maintaining flexibility is wise for individuals planning their career strategies and for firms.



SOURCE: [Brett Jordan](#).

For firms, these unexpected twists and turns place limits on the value of strategic planning. Former heavyweight boxing champion Mike Tyson captured the limitations of strategic plans when he noted, "Everyone has a plan until I punch them in the face." From that point forward, strategy is less about a plan and more about adjusting to a shifting situation. For firms, changes in the behaviour of competitors, customers, suppliers, regulators, and other external groups can

all be sources of a metaphorical punch in the face. As events unfold around a firm, its strategic plan may reflect a competitive reality that no longer exists. Because the landscape of business changes rapidly, other ways of thinking about strategy are needed.

## Strategy as a Ploy

A second way to view strategy is in terms of ploys. A **strategic ploy**<sup>74</sup> is a specific move designed to outwit or trick competitors. Ploys often involve using creativity to enhance success. Think of Mark Twain's *Tom Sawyer*, where Tom the principal character is stuck whitewashing a fence instead of playing or going to the swimming hole. His one attempt at bribery did not work. He convinced his friends that he enjoyed painting: "Like it? Well, I do not see why I ought not to like it. Does a boy get a chance to whitewash a fence every day?" He manipulated his friends into gladly paying him for a chance to whitewash Aunt Polly's fence (Twain, 1876).

Ploys can be especially beneficial in the face of much stronger opponents. Military history offers quite a few illustrative examples. Before the American Revolution, land battles were usually fought by two opposing armies, each of which wore brightly coloured clothing, marching toward each other across open fields. George Washington and his officers knew that the United States could not possibly defeat better-trained and better-equipped British forces in a traditional battle. To overcome its weaknesses, the American military relied on ambushes, hit-and-run attacks, and other guerilla moves. It even broke an unwritten rule of war by targeting British officers during skirmishes. This was an effort to reduce the opponent's effectiveness by removing its leadership.

Centuries earlier, the Carthaginian general Hannibal concocted perhaps the most famous ploy ever. Carthage was

at war with Rome, a scary circumstance for most Carthaginians given their far weaker fighting force. The Alps had never been crossed by an army. In fact, the Alps were considered such a treacherous mountain range the Romans did not bother monitoring the part of their territory that bordered the Alps. No horse was up to the challenge, but Hannibal cleverly put his soldiers on elephants, and his army could make the mountain crossing. The Romans were caught completely unprepared and most of them were frightened by the sight of charging elephants. By using the element of surprise, Hannibal could lead his army to victory over a much more powerful enemy.

Ploys continue to be important today. In 2011, a pizzeria owner in Pennsylvania was accused of making a rather unique attempt to outmanoeuvre two rival pizza shops. According to police, the man tried to sabotage his competitors by placing mice in their pizzerias. If the ploy had not been discovered, the two shops could have suffered terrible publicity or even been shut down by authorities because of health concerns. Although most strategic ploys are legal, this one was not, and the perpetrator was arrested (Reuters, 2011).

## Strategy as a Pattern

**Strategy as pattern**<sup>75</sup> is a third way to view strategy. This view focuses on the extent to which a firm's actions over time are consistent. A lack of a strategic pattern helps explain why distillery giant Seagram's deteriorated into massive losses and became the target of a takeover. The company was started in the mid-1850s as a distiller in Montreal. After Prohibition in the United States ended in 1933 (which itself was a boom for Seagram's through sales to bootleggers), Seagram Co. Ltd. was ready for the pent-up demand for alcohol from U.S. consumers. At the firm's peak in the mid-1950s, one out of every three

distilled-alcohol drinks consumed by Americans was made by Seagram (Slater, 2013).

Cash-rich, the company diversified, first buying other beverage companies, wine, champagne, cognac, and even orange juice with the purchase of Tropicana Products. One of Seagram's most profitable investments was a large minority share in chemical giant DuPont. However, in 1994, Edgar Bronfman Jr. took over at Seagram's, and continued a diversification strategy, pushing into the entertainment business, an area that Seagram's knew little about. Things went so poorly, in 2000, Seagram sold their profitable DuPont holdings to France's Vivendi SA, a European telecommunications giant. The deal ended up destroying much of the Bronfman family fortune (Slater, 2013).

In contrast, Apple has very consistent in its strategic pattern: it always responds to competitive challenges by innovating. Some of these innovations are complete busts. Perhaps the best known was the Newton, a tablet-like device that may have been ahead of its time. Another was the Pippin, a video game system introduced in 1996 to near-universal derision. Apple TV, a 2007 offering intended to link televisions with the Internet, also was slow to attract customers. However, in 2014, the \$99 box is selling well: Tim Cook (Apple CEO) just told shareholders that the company generated more than \$1 billion in Apple TV sales in 2013—which implies sales of over 10 million units. There are risks to following a pattern too closely. A consistent pattern can make a company predictable, a possibility that Apple must guard against in the years ahead (Kafta, 2014).

## Strategy as a Position

Viewing strategy as a plan, a ploy, and a pattern involve only the actions of a single firm. In contrast, the next P

(**strategy as position**<sup>76</sup>) considers a firm and its competitors. Specifically, strategy as position refers to a firm's place in the industry relative to its competitors. McDonald's, for example, has long been and remains the leader among fast food chains. This position offers both good and bad aspects for McDonald's. One advantage of leading an industry is that many customers are familiar with and loyal to leaders. Being the market leader, however, also makes McDonald's a target for rivals such as Burger King and Wendy's. These firms create their strategies with McDonald's as a primary concern. Old Navy offers another example of strategy as position. Old Navy has been positioned to sell fashionable clothes at competitive prices.



["The first Wendy's 7-15-2006 \(1\)" by Corvair Owner.](#)

Old Navy is owned by the same corporation (Gap Inc.) as the midlevel brand the Gap and upscale brand Banana Republic. Each of these three brands is positioned at a different pricing level. The firm hopes that as Old Navy's customers grow older and more affluent, they will shop at the Gap and then eventually at Banana Republic. A similar positioning of different brands is pursued by General Motors through its

Chevrolet (entry-level), Buick (midlevel), and Cadillac (upscale) divisions.

Firms can carve out a position by performing certain activities differently than their rivals. WestJet Airlines Ltd., based in Calgary, Alberta, can position itself as a price leader by offering the lowest price, lowest cost structure, has excellent service, and delivers a superior experience. The company pioneered paper-free ticketing, consumer phone bookings, and the snack and bag lunch. They use Boeing 737 airplanes exclusively, stocking parts and training staff based on one model of plane. WestJet uses the A to B model rather than a web and spokes model, which is common with airlines such as Air Canada.

Air Canada accumulates people in hub cities to get them to the spokes, which are smaller centres. There is a higher cost structure to support the 1 to 2 hours between flights for the hub and spokes model. Air Canada, designated as Canada's national airline, is legislated to provide services to hubs and spokes. WestJet can "cherry-pick," flying only the most profitable routes, which is an obvious major advantage not available to Air Canada (Business in Vancouver, 2003). Westjet has equipped many of their airport gates with two airplane bridges (a second one connects to the door at the rear of the plane), enabling them to off-load and re-load passengers twice as fast as Air Canada. This quicker turnaround time directly supports higher profits, an airplane on the tarmac is simply a cost item! The only time airplanes generate income is while they are flying.

When firms position themselves through unique goods and services that customers value, business often thrives. But when firms try to please everyone, they often find themselves without the competitive positioning needed for long-term success. Deciding what a firm will not do is just as important to strategy as deciding what it is going to do (Porter, 1996). To gain competitive advantage and greater success,

firms sometimes change positions. But this can be a risky move. Zellers became a successful department store by targeting moderate-income customers. When the firm abandoned this established position to compete for wealthier customers and higher margins, the results were disastrous. The firm was forced into bankruptcy and closed many stores. Zellers eventually sold many of its locations to Target, a new entrant to the Canadian marketplace. In contrast to firms such as Zellers that changed positions, Apple has long maintained a position as a leading innovator in various industries. This positioning has served Apple well.

## Strategy as a Perspective

The fifth and final P shifts the focus to inside the minds of the executives running a firm. **Strategy as perspective**<sup>77</sup> refers to how executives interpret the competitive landscape around them. Because each person is unique, two different executives could look at the same event—such as a new competitor emerging—and attach different meanings to it. One might just see an additional threat to his or her firm's sales; the other might view the newcomer as a potential ally.

Video 1. Newfoundland and Labrador Tourism





*A YouTube element has been excluded from this version of the text. You can view it online here:*

<https://pressbooks.library.upei.ca/startup/?p=532>

#### [\(Video Link\)](#)

An old cliché urges listeners to “make lemons into lemonade.” A good example of applying this idea through strategy as perspective is provided by Newfoundland and Labrador Tourism (see Video below). Ads played up the charming and old-fashioned place names such as Tickle Cove and Cupids, along with spectacular photography to create a perception of a charming, quiet, and exotic destination compared to Disneyland. These strategists will take a possibly negative situation and see the potential upside.

Executives who adopt unique and positive perspectives can lead firms to find and exploit opportunities that others simply miss. In the mid-1990s, the Internet was mainly a communication tool for academics and government agencies. Jeff Bezos looked beyond these functions and viewed

the Internet as a potential sales channel. After examining several markets that he might enter using the Internet, Bezos saw strong profit potential in the bookselling business, and he began selling books online. Today, the company he created—Amazon—has expanded far beyond its original focus on books to become a dominant retailer in countless different markets. The late Steve Jobs at Apple appeared to take a similar perspective; he saw opportunities where others could not, and his firm has reaped significant benefits.

### *Key Takeaways*

Strategic management focuses on firms and the different strategies that they used to become and remain successful. Multiple views of strategy exist, and the 5 Ps described by Henry Mintzberg enhance understanding of the various ways in which firms conceptualize strategy.

### *Exercises*

- Have you developed a strategy to manage your career? Should you make it more detailed? Why or why not?
- Identify an example of each of the 5 Ps of

strategy other than the examples offered in this section.

- What business that you visit regularly seems to have the most successful business model? What makes the business model work?

## Managing Firm Resources

### *Learning Objectives*

- What is resource-based theory, and why is it important to organizations?
- In what ways can intellectual property serve as a value-added resource for organizations?
- How should executives use the value chain to maximize the performance of their organizations?
- What is SWOT analysis and how can it help an organization?



[“N8676A Southwest Airlines Boeing 737-8H4 s/n 36941” by TDelCoro.](#)

## Southwest Airlines: Let Your LUV Flow

In 1971, an upstart firm named Southwest Airlines opened for business by offering flights between Houston, San Antonio, and its headquarters at Love Field in Dallas. From its initial fleet of three airplanes and three destinations, Southwest has grown to operate hundreds of airplanes in scores of cities. Despite competing in an industry infamous for bankruptcies and massive financial losses, Southwest marked its 41<sup>st</sup> profitable year in a row in 2014.

Why has Southwest succeeded while many other airlines have failed? Historically, the firm has differed from its competitors in a variety of important ways. Most large airlines use a “hub and spoke” system. This type of system routes travellers through a large hub airport on their way from one city to another. Many Delta passengers, for example, end a flight in Atlanta and then take a connecting flight to their actual destination. The inability to travel directly between most pairs of cities adds hours to a traveller’s itinerary and increases the chances of luggage being lost and missed flights. In

contrast, Southwest does not have a hub airport; preferring instead to connect cities directly. This helps make flying on Southwest attractive to many travellers.

Southwest has also been more efficient than its rivals. While most airlines use a variety of different airplanes, Southwest operates only one type of jet: the Boeing 737. This means that Southwest can service its fleet much more efficiently than can other airlines. Southwest mechanics need only the knowledge to fix one type of airplane, for example, while their counterparts with other firms need a working knowledge of multiple planes. Similarly, Southwest only needs to train its pilots to fly one type of plane. Southwest also gains efficiency by not offering seat assignments in advance, unlike its competitors. This makes the boarding process move more quickly, meaning that Southwest's jets spend more time in the air transporting customers and goods (and making money) and less time at the gate relative to its rivals' planes (Schlangenhein & Hughes, 2010).

Organizational culture is the dimension along which Southwest perhaps has differed most from its rivals. The airline industry suffers from a reputation for mediocre (or worse) service and indifferent (sometimes even surly) employees. In contrast, Southwest enjoys strong loyalty and a sense of teamwork among its employees.

One tangible indicator of this culture is Southwest's stock ticker symbol. Most companies choose stock ticker symbols that evoke their names. Ford's ticker symbol is F, for example, and Walmart's symbol is WMT. When Southwest became a publicly traded company in 1977, executives chose LUV as its ticker symbol. LUV pays a bit of homage to the firm's humble beginnings at Love Field. More important, however, LUV represents the love that executives have created among employees, between employees and the company, and between customers and the company. This "LUV affair" has long been and remains a tremendous success. As recently as

March 2011, for example, Southwest was ranked fourth on *Fortune* magazine's World's Most Admired Company list.

WestJet Airlines Ltd. of Calgary may have learned a thing or two from Southwest's template for resource management. In 1996, WestJet started with three aircraft and five destinations (WestJet, 2012). Using only Boeing 737s, WestJet employees are also known for a culture of caring and fun on their flights. The airline was the first in Canada to introduce paperless ticketing, direct ticket purchase, and buy-on-board meal service, which other airlines have since adopted. WestJet has recently reconfigured the aircraft interiors with narrower aisles and lighter weight seating to increase capacity while decreasing aircraft weight. They have also adopted a second, smaller airplane, and have been moving into smaller, northern communities, where they have been well received.



["C-GWSB YVR"](#) by [airlines470](#).

WestJet uses the hub and spoke model, partly because of the configuration of its service area, such as destinations in northern Canada. Air Canada, the national air carrier, is mandated to serve all operating airports in Canada, including the smaller and remote communities. In contrast, WestJet can

“cherry-pick” its routes, a major contribution to its operational and financial efficiency.

## Intellectual Property

### *Learning Objectives*

- Define the four major types of intellectual property.
- Be able to provide examples of each intellectual property type.
- Understand how intellectual property can be a valuable resource for firms.

The inability of competitors to imitate a strategic resource is a key to leveraging the resource to achieve long-term competitive advantages. Companies are clever, and effective imitation is often very possible. But resources that involve intellectual property reduce or even eliminate this risk. As a result, developing intellectual property is important to many organizations. **Intellectual property**<sup>78</sup> is the legal rights that result from intellectual activity in the industrial, scientific, literary, and artistic fields (Canadian Intellectual Property Office, 2014).

Figure 1. Types of Intellectual Property



### Patents

Protect inventions from direct imitation for a limited period. Within the pharmaceutical industry, if a new drug gains acceptance in the market, its patent creates a window of opportunity for the patent holder to enjoy excellent profits.

### Trademarks

Are phrases, pictures, names, or symbols used to identify a particular organization. McDonald's golden arches, brand name Nike and swoosh, "Intel inside" are all trademarks.

### Copyrights

Provide exclusive rights to the creators of original artist's works, such as books, movies, songs, and screenplays. Sometimes copyrights are sold and licensed.

### Trade Secrets

Refer to formulas, practices, and designs that are central to a firm's business and remain unknown to the competitor. KFC protects its recipe by having multiple suppliers, producing a portion of the herb and spice blend.

SOURCES (L to R): [Pixabay](#); [C. Cagnin](#); [Aman Jakhar](#); [Pixabay](#).

The four main types of intellectual property are patents, trademarks, copyrights, and trade secrets. If a piece of intellectual property is valuable, rare, and non substitutable, it can also make up a strategic resource. Even if a piece of intellectual property does not meet all four criteria as a strategic resource, it can be bundled with other resources and activities to create a strategic-level resource.

A variety of formal and informal methods are available to protect a firm's intellectual property from imitation by rivals. Some forms of intellectual property are best protected by legal means, while defending others depends on surrounding them in secrecy. For example, KFC's secret blend of 11 herbs and spices is famous for being a trade secret. This can be contrasted with WestJet Airlines' well-known culture, which rivals are free to copy if they wish. WestJet's culture thus is not intellectual property, although some of its complements such as WestJet's logo and unique colour schemes are.

## Patents

**Patents**<sup>79</sup> are legal decrees that protect inventions



from direct imitation for a limited period. In Canada, a patent is a right, granted by government, to exclude others from making, using, or selling your invention for 20 years after the patent application is filed. Getting a patent involves navigating a challenging process. To earn a patent from the Canadian Intellectual Property Office, there are three basic criteria for patentability:

1. The invention must show *novelty* (be the first in the world).
2. Show *utility* (be functional and operative).
3. Show inventive *ingenuity* and not be obvious to someone skilled in that area.

A patent is granted only for the physical embodiment of an idea (for example, the description of a door lock) or for a process that produces something tangible or can be sold. You cannot patent a scientific principle, an abstract theorem, an idea, some methods of doing business, or a computer program per se. Once an invention is patented in Canada, exclusive rights are granted to the patent holder as defined in the Patent Act (Government of Canada, 1985). Any interference with the patent holder's "full enjoyment of the monopoly granted by the patent" is considered a patent infringement (CanLII, 2004).

You may get a patent for an improvement to an existing invention, but keep in mind that the original patent may still be in force. If this is the case, manufacturing or marketing the product with your improvement would probably be an infringement. This situation is often resolved by agreement between the patentees to grant licences to each other.

In 1986, *Windsurfing International Inc. v. Trilantic Corp.* dealt with a manufacturer selling the unassembled components of a patented sailboard (1986). In the court's decision, it was stated:

*"Without assembly there can be no purpose in a purchaser buying the unassembled parts since, unassembled, they cannot be used for the*

*purpose for which they are purchased, that is, to sail. To suggest that a patent infringement suit can be successfully avoided by selling parts as components of a kit in contradistinction to their sale assembled is, in my view, errant nonsense."*

*–Windsurfing International Inc. v. Trilantic Corp.*  
(1986), 8 C.P.R. (3d) 241

One alternative is to maintain the innovation as a trade secret. This can be very cost-effective protection and, unlike a patent, can last indefinitely. However, once the secret is out, the protection is completely lost. Trade secret protection gives you no rights against third parties who independently discover the same invention and patent it.

Patenting an invention is important because patents can protect and generate enormous profits. Imagine, for example, the potential for lost profits if the Slinky had not been patented. Shipyard engineer Richard James came up with the idea for the Slinky by accident in 1943 while he was trying to create springs for ship instruments. When James accidentally tipped over one of his springs, he noticed it moved downhill in a captivating way. James spent his free time perfecting the Slinky and then applied for a patent in 1946. As noted above, in 1966 the patent expired, and anyone can now use this invention. The company that Richard James and his wife Betty created has sold to date, more than 300 million Slinkys.



SOURCE: [Tara Winstead](#).

## Trademarks

**Trademarks<sup>80</sup>** are a word (or words), a design, or a combination of these used to identify the goods or services of one person or organization and are important because they help an organization stand out by building an identity in the marketplace. Some trademarks are so iconic that almost all consumers recognize them, including McDonald's golden arches, the Nike swoosh, and Apple's outline of an apple.

Figure 2. Counterfeit Soft Drinks



["Counterfeit soft drinks"](#) by [Richard Masoner / Cyclelicious](#).

Other trademarks help to rise companies carve out a unique niche for themselves. For example, French shoe designer Christian Louboutin has trademarked the signature red sole of his designer shoes. Because these shoes sell for many hundreds of dollars at upscale retailers, competitors would love to copy that look. Thus, legally protecting the distinctive red sole from imitation helps preserve Louboutin's profits. It should be noted that although the average consumer might not identify the specific shade of red, that was granted a trademark, a similar, but different, red colour used in shoe soles was deemed not to be a trademark infringement.

Trademarks are important to colleges and universities. Schools earn tremendous sums of money through royalties on T-shirts, sweatshirts, hats, backpacks, and other consumer goods sporting their names and logos. On any day, there are probably several students in your class wearing one or more pieces of clothing featuring your school's insignia; your school benefits every time items like this are sold.

Schools' trademarks are easy to counterfeit, however, and the sales of counterfeit goods take money away from

colleges and universities. Counterfeit products are often inferior in quality and may even pose a potential health or safety hazard to the consumer. Many schools and other entities fight to protect their trademarks, including educating consumers. The Vancouver Canucks website (and those of many other national sports teams) features a section called “Fight the Fake” that includes tips on ways to spot counterfeit products to promote the allowed version and protect one of its sources of revenue (NHL.com, 2014).

## Copyrights

**Copyrights**<sup>81</sup> provide exclusive rights to the creators of original artistic works such as books, movies, songs, and screenplays. Unlike patents that are only enforceable for 20 years, copyright exists for the duration of author’s lifetime plus an additional 50 years.

Sometimes copyrights are sold and licensed. In the late 1960s, Buick thought it had an agreement in place to license the number one hit “Light My Fire” for a television advertisement from The Doors until the band’s volatile lead singer Jim Morrison loudly protested what he saw as mistreating a work of art. Classic rock by The Beatles has been used in television ads in recent years. After the late pop star Michael Jackson bought the rights to the band’s music catalogue, he licensed songs to Target and other companies. Some devoted music fans consider such advertisements to be abominations, perhaps proving the merit of Morrison’s protest decades ago.

Over time, **piracy**<sup>82</sup> has become a huge issue for the owners of copyrighted works. In China, millions of pirated DVDs are sold each year, and music piracy is estimated to account for at least 95% of music sales. This piracy deprives movie studios, record labels, and artists of millions of dollars in potential

royalties. In response to the damage piracy has caused, the Canadian and U.S. governments have pressed their Chinese counterpart and other national governments to better enforce copyrights.



SOURCE: [Cottonbro](#).

## Trade Secrets

The definition of a trade secret can vary from one jurisdiction to another. It is information that provides a business advantage over a competitor and is subject to reasonable efforts to maintain its secrecy. Trade secrets can be formulas, practices, designs, patterns, data compilations, devices or instruments, processes, etc. Sometimes a trade secret can be protected contractually through certain legal concepts and statutes.

Trade secrets cover a very wide variety of items, contained or embodied in, but not limited to, a formula, pattern, plan, compilation, computer program, method, technique, process, product, device or mechanism; it may be

information of any sort; a scientific idea, or of a literary nature. Trade secrets grant an economical advantage to the business and improve its value (Turner, 1962). There must be some element of secrecy. Matters of public knowledge or of general knowledge in an industry cannot be the subject of a trade secret (Vaver, 1981)

Some trade secrets have become legendary, perhaps because a mystique arises around the unknown. One famous example is the secret blend of 11 herbs and spices used in KFC's original recipe chicken. KFC protects this secret by having multiple suppliers each produce a portion of the herb and spice blend; no one supplier knows the full recipe. Similarly, Coca-Cola's flavour mix is also shrouded in mystery. In 2006, shady individuals who were offering a chance to buy a stolen copy of Coca-Cola's secret recipe approached Pepsi, which Pepsi wisely refused. An FBI sting was used to bring the thieves to justice. The soft drink industry has other secrets too. Dr Pepper's recipe remains unknown outside the company. Although Coke's formula has been the subject of greater speculation, Dr Pepper is the original secret soft drink that was created a year before Coca-Cola.

### *Key Takeaways*

Intellectual property can serve as a strategic resource for organizations. While some sources of intellectual property such as patents, trademarks, and copyrights can receive special legal protection, trade secrets provide competitive advantages by simply staying hidden from competitors.

## Exercises

- What designs for your college or university are protected by trademarks?
- What type of intellectual property provides the most protection for firms?
- Why would a firm protect a resource through trade secret rather than by a formal patent?

## Operational Steps to Launch

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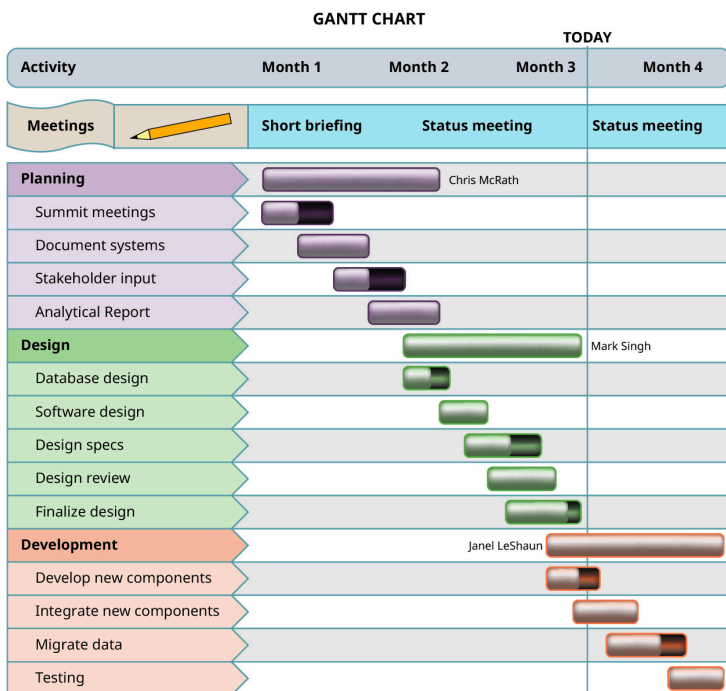


SOURCE: [Artem Beliaikin](#).



The next action is outlining the operational steps in the venture creation process. A good approach is to create a chart that identifies how you should proceed. The goal in creating this chart is to recognize what actions need to be taken first. For example, if you need a convection oven for your business, what is the timeline between ordering and receiving the oven? If you need ten employees to prepare and package your product, how long will it take to interview and hire each person? According to Glassdoor, the hiring process took 23 days in 2014 and appears to be lengthening in time as organizations become more aware of the importance of hiring the right person.<sup>83</sup> What about training? Will your employees need training on your product or processes before starting the venture? These necessary outcomes need to be identified and then tracked backwards from the desired start date to include the preparatory actions that support the success of the business. You have probably heard the phrase that timing is everything. Not only do entrepreneurs need to be concerned about finding the right time to start the venture, but they also need the right timing to orchestrate the startup.

Figure 3. Gantt Chart Example



Above is a sample **Gantt Chart**, a method to track a list of tasks or activities aligned with time intervals. You can use this tool to help identify and schedule the operational steps that need to be completed to launch the venture. One approach to creating a Gantt chart is for each team member to create a list of operational activities or tasks required to start the venture that fall under their area of involvement. Then the team can create a master list of activities to discuss: This helps clarify who is contributing to or owning each task. Next, have all team members create their own Gantt chart based on their task list: That is, the time required for each task should be spelled out, including steps that must happen sequentially (when one task cannot be started until another step is complete). Once again, bring all team members together to create one master Gantt chart. This will help ensure that dependencies from member to member are accounted for in

the planning. These contingencies and dependencies need to be identified and accommodated for in the master schedule. After completing the chart, agree on assignments of responsibility to follow through on the activities, based on the timelines from the Gantt chart.

## **Launch Considerations**

Sage advice in launching the new venture is to recognize when you do not have the answer or information to make the best decisions. In the early-stage of launching the venture, the level of uncertainty is high, as is the need for agility and spontaneity. Even identifying the actual moment when the venture becomes a new venture can be difficult to determine. Should the venture be recognized as a new venture after receiving the licenses or tax identification number, or when the first sale occurs, or when funds are first invested, or by some other method?

It is also important to keep in mind the end goal of the venture, often referred to as “begin with the end in mind.” For example, many highly successful ventures never earn a dollar in sales. Depending on the entrepreneurial team's vision and the business model selected, the venture could be highly valuable from a harvest, or sale of the venture, perspective. Frequently, this decision is dictated by the angel investor. These people frequently started their own venture, harvested the venture, and as a result have funds available to invest in other new ventures. In most cases, the angel investor expects to cash out of the venture in the future. These are investors who are not interested in holding a long-term equity position but expect to grow the venture into a position where another company buys out the venture. This buyout is also known as the harvesting of the venture and the point at which the angel investor receives a percentage of the harvested dollar sale to cover the equity

stake in the new venture. Because of this pattern, entrepreneurs are often advised to “begin with the end in mind” when launching a new venture. If the goal is to sell the venture to another company, we want to identify that company before launching the venture. Of course, this is only a desire or hope, as you cannot require or expect another company to have an interest in your new venture. But you can design the new venture to align with this end goal by making decisions that support this goal.

Consider the example of YouTube, a startup with zero dollars in sales but with a harvest price of \$1.65 billion in stock from Google. The startup team, former PayPal colleagues, understood that the technology was being developed for video searching and recognized that creating a platform to house video sharing would be desired by companies such as Google in the future. Consider the tight timeline between 2005 when YouTube began supporting video sharing, and the harvest of YouTube to Google in 2006, 21 months. Launching your venture is a unique experience for every entrepreneurial team and for every venture. These novel situations and uncertainties create both challenges and new learning opportunities.

Accepting that a multitude of possibilities exists and recognizing the importance of researching and discussing actions are valuable to the success of the team. Angel investors hold a wealth of knowledge, and with an equity stake in the venture, these investors should be included in all discussions. If you have an angel investor on your team, you have an added advantage to tap into the expertise available to support the venture. With a well-aligned angel investor, conducting research to explore decisions will improve your venture’s success. Although these decisions might seem difficult, the next section addresses how to approach hard decisions and the role emotional connections for the venture and its team play in those decisions.



SOURCE: [Pixabay](#).

## Footnotes

[68](#) The set of external conditions and forces that have the potential to influence the organization.

[69](#) Industry (competitive environment): Multiple organizations that collectively compete with one another by providing similar goods, services, or both.

[70](#)

General environment (macroenvironment): Overall trends and events in society such as social trends, technological trends, demographics, and economic conditions.

[71](#) **Opportunities:** Events and trends that create chances to improve an organization's performance level.

[72](#) **Threats:** Events and trends that may undermine an organization's performance.

[73](#) **Economies of scale:** A cost advantage created when a firm can produce a good or service at a lower per unit price due to

producing the good or service in large quantities.

**74 Strategic ploy:** A specific move designed to outwit or trick competitors.

**75 Strategy as pattern:** The extent to which a firm's actions over time are consistent.

**76 Strategy as position:** A firm's place in the industry relative to its competitors.

**77 Strategy as perspective:** How executives interpret the competitive landscape around them.

**78 Intellectual property:** The legal rights that result from intellectual activity in the industrial, scientific, literary, and artistic fields (Canadian Intellectual Property Office, 2014).

**79 Patent:** Legal decree that protects inventions from direct imitation for a limited period.

**80 Trademark:** A word (or words), a design, or a combination of these used to identify the goods or services of one person or organization.

**81 Copyright:** Provides exclusive rights to the creators of original artistic works such as books, movies, songs, and screenplays.

**82 Piracy:** Theft of trademark or copyrighted material.

**83** Glassdoor Team. "How Long Should the Interview Process Take?" June 18, 2015. <https://www.glassdoor.com/blog/long-interview-process/>

# 9/ Risks

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Source: [Anna Nekrashevich](#).

## Mitigating and Managing Risks

### *Learning Objectives*

- Explain Enterprise Risk Management and how a company uses it.

- Describe litigation and financial risks.
- Describe common insurance needs.

Risk management is key to operating any business profitably. There are many risks facing an entrepreneur when starting and operating a new business venture. The trick is to eliminate risks that will hurt the venture, while taking on risks that will provide for long-term profitability. The risks facing the entrepreneur need to identify as part of developing a business plan and revisited regularly in ongoing operations. Preparation for adverse events affecting a new business venture is necessary but being too pessimistic or allowing fear of adverse events to stop an entrepreneur from taking any risk will keep a business venture from achieving its greatest potential and profit.

It is important that an entrepreneur develop an understanding of the risks of the business environment. The risks include liability risks stemming from contracts and torts, sometimes referred to as operating risks, regulatory compliance risks, financial risks, and strategic risks, including taxation. Understanding how the business structure is used to operate the business venture allows the entrepreneur to develop a plan to manage business growth and understand business risk.

## Enterprise Risk Management

Profitable ventures develop a strong **enterprise risk management** program, which is an integrated, cross-disciplinary approach to monitoring risk. An organization



needs to look at both long-term and short-term risks at all levels of the organization, and these risks need to be evaluated from all stakeholders' perspectives and developed into an entity-wide program.

Enterprise risk management attempts to address the specific risks discussed in the preceding section by implementing a risk program that enables a business to identify and manage risk. Specifically, a business will go through a process that involves a multistage process of risk identification, risk assessment, and risk abatement. Examples of risks that businesses face include those from natural causes, economic causes, and human causes.

Natural causes of risk include disasters such as hurricanes and flooding, as well as earthquakes or other catastrophes that result in loss of life and property, as well as business interruption. For example, a business in New Orleans could be flooded by a hurricane. This results in damage to facilities and products and threatens the lives of workers. To counter such causes, businesses need to plan for business continuity, take out comprehensive insurance coverage, and have an evacuation/shut down plan in place.

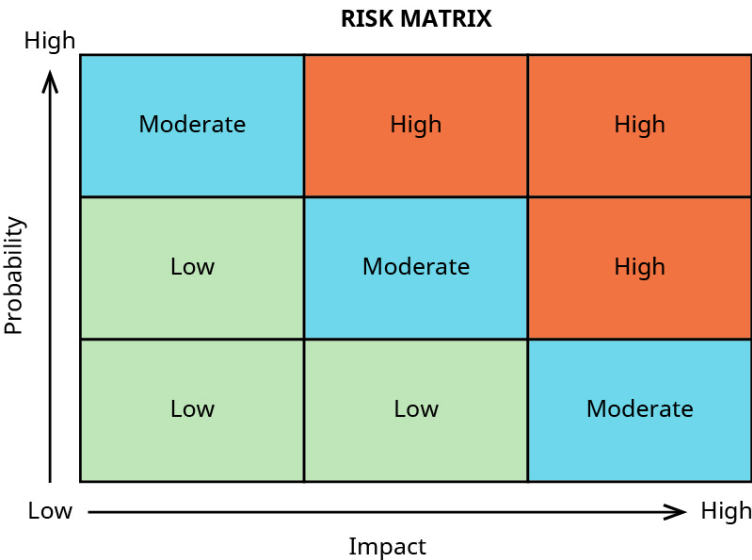
Economic causes of risk include global events leading to rising prices of raw materials, currency fluctuation, high interest rates, and, of course, competition from other companies in the same industry. An example of this would be unpredictable trade wars with China, leading to tariffs.

Human causes of risk refer to actions by employees, contractors, and those persons over which a company has control. These events can include torts stemming from negligence at work, labour strikes, shortages of qualified trained workers, and corporate mismanagement. An example of this type of risk would include embezzlement of money by an internal financial executive.

Using a comprehensive approach allows a business entity to review and combine all risks into a functional

perspective that allows the entrepreneur to evaluate risks and integrate additional risks as different opportunities become more important to the business venture. Businesses sometimes use a risk matrix to assess or characterize the probability and impact of risk (see Figure below). Such a tool can help a business quantify risk and decide whether to undertake an activity based on its level of risk.

Figure 1. Risk Matrix



SOURCE: Copyright Rice University, OpenStax, under CC BY 4.0 license)

Risk appetite is important for a business venture to consider, both when creating its business structure and during ongoing operations. The Table below shows an overview of the considerations a business venture should entertain in both its creation and operation.

Table 1. Risk Appetite<sup>84</sup>

Risk Item	Consideration
Existing risk profile	Current level and distribution of risks across the business
Risk capacity	Amount of risk the business can support while maintaining its strategic goals
Risk tolerance	Amount of variation the business can tolerate without taking corrective action
Risk attitude	Management's attitudes toward growth, risk, and the role of risk management

*COSO's Enterprise Risk Management, Understanding and Communicating Risk Appetite* outlines these considerations for assessing a business's appetite for risk.

This is the basic approach to evaluating a new venture's appetite for risk. Determining and understanding the risks facing a new venture should start when preparing the business venture's written business plan and should continue through the operations of the venture.

## Legal Risk and Protection

Business operations of any sort need to follow business regulations and laws. Failing to follow business regulations may lead to fines, lawsuits, or even criminal penalties. **Legal risk** stems primarily from a breach of contract and/or the commission of a tort. Common examples of this type of risk includes product liability lawsuits. These lawsuits are frequently very expensive class action lawsuits or regulatory investigations of dangerous products. There are many famous case examples including automobiles, asbestos, pharmaceutical drugs, breast implants, and airplanes.

Other lawsuits stem from contracts, including borrowing money from a bank. The business has an obligation

to pay it back, or it breaches a covenant within a contract. Other common types of contracts are those used in selling services and products, leasing real estate, and other similar contractual obligations.

Because of liability risks, business owners, and investors are always looking for ways to limit their personal liability. Incorporation is a standard risk protection strategy for this potential problem, as are the use of other types of limited liability structures such as LLCs. Partners in GPs and sole proprietors are personally liable for all the debts of the business, even beyond their own investment in the business. A particular challenge for small business entrepreneurs is that even when they form a corporation or LLC, many lenders, landlords, and other entities providing credit to a small business circumvent the limited liability protection by requiring owners and investors to personally guarantee the debts of the business operations. This means that the owner who guarantees the credit will have to pay back the obligation if the business cannot. An owner can get insurance or borrow money for such guarantees. LLCs and corporations protect their owners, shareholders, and members from several tort claims, such as personal injury lawsuits and claims made directly against the organization.

## **Financial Risk and Protection**

An entrepreneur needs money to launch a business, whether that comes as loans from family, their own savings, or investors. The founder will be expected to put their own money at risk, whether as a loan to their own business or equity in their own business. If they do not have any “skin in the game,” then others will not be interested in loaning them money. This means that if the business fails, it will have repercussions for the owner, even if they operate as a corporation or LLC. This

is the essence of **financial risk**: starting a new business with insufficient funds to sustain operations over a period.

Any new business owner needs to have a sound financial strategy as a part of the overall business plan. This should show income projections, the liquid assets that will be required to break-even, and the expected return on investment for all investors in the first five-to-ten-year timeframe. Failure to plan could mean that the entrepreneur risks business closure and bankruptcy, and investors get nothing.

## Insurance Protection

Risk management and protection are enhanced with the purchase of different **insurance**, which involves spreading risk over many people (policyholders). If a company is a corporation, it may need directors' and officers' liability insurance to indemnify the directors and officers if they get sued. Another insurance policy many companies get is called errors and omissions insurance, and this insurance coverage protects employees in negligence claims and cases of employee theft. Other types of insurance policies that most businesses carry include automobile insurance, health insurance, property insurance, and cyber/data breach insurance. Insurance coverage for a business venture needs to be specific to the business structure and its operations. Keep in mind that not all risks can be insured against—for example, a poor economy that leads to a loss of business or a critical decision by the owner to enter a market that does not work out.

# Information Technology/Cybersecurity for Small Business

Table 2. Small Business Administration Recommendations for Cybersecurity<sup>85</sup>

Step	Action
1	Protect against viruses, spyware, and other malicious code
2	Secure your networks
3	Establish security practices and policies to protect sensitive information
4	Educate employees about cyber threats and hold them accountable
5	Require employees to use strong passwords and change them often
6	Employ best practices on payment cards
7	Make backup copies of important business data and information
8	Control physical access to computers and network components
9	Create a mobile device action plan
10	Protect all pages on your public-facing websites and apps, not just the home page

According to the SBA, the risk of hacking, ransomware, and customer privacy are equally significant for most small businesses as for larger ones. The SBA has set guidelines related to cybersecurity for entrepreneurs. The SBA recommends the ten-step action plan shown in the table below.

## Managing Payment Data

If you operate a small business, are you prepared to deal with hackers who break into your website and steal credit card data from consumers who bought your products online? Small businesses running an e-commerce site must comply with the Payment Card Industry Data Security Standard (<https://www.pcisecuritystandards.org/>). This is a regulation that could cause severe legal risk for entrepreneurs if your system is compromised, and credit card data are stolen. Consumers rightfully expect and demand a safe online experience when they visit your site. Have you paid an expert to evaluate your system and install the best security system? It may be costly, but perhaps not as expensive as the damages you could be ordered to pay by a court if credit card data are hacked.

## Develop Tactical and Operational Plans

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The planning process begins at the top of the organization, where upper-level managers create a strategic plan, but it does not end there. The *execution* of the strategic plan involves managers at all levels.

## Tactical Plans

The plan is broken down into more manageable, shorter-term components called **tactical plans**. These plans

specify the activities and allocation of resources (people, equipment, money) needed to implement the overall strategic plan over a period. Often, a long-range strategic plan is divided into several tactical plans; a five-year strategic plan, for instance, might be implemented as five one-year tactical plans.

## Operational Plans

The tactical plan is then broken down into various **operational plans** that provide detailed action steps to be taken by individuals or groups to implement the tactical plan and the strategic plan. Operational plans cover only a brief period, say, a week or a month. At Notes-4-You, for example, note-takers might be instructed to turn in typed class notes five hours earlier than normal on the last day of the semester (an operational guideline). The goal is to improve the customer satisfaction score on dependability (a *tactical goal*) and, as a result, to earn the loyalty of students through attention to customer service (a *strategic goal*).

## Plan for Contingencies and Crises

Even with brilliant planning, things do not always turn out the way they are supposed to. Perhaps your plans were flawed, or maybe you had great plans but something in the environment shifted unexpectedly. Successful managers expect and plan for the unexpected. Dealing with uncertainty requires *contingency planning* and *crisis management*.



## Contingency Planning

With **contingency planning**, managers identify those aspects of the business that are most likely to be adversely affected by change. Then, they develop alternative courses of action in case an expected change occurs. You probably do your own contingency planning: for example, if you are planning to take in a sure-fire hit movie on its release date, you may decide on an alternative movie in case you cannot get tickets to your first choice.

## Crisis Management

Organizations also face the risk of encountering crises that require immediate attention. Rather than waiting until such a crisis occurs and then scrambling to figure out what to do, many firms practice **crisis management**. Some, for instance, set up teams trained to deal with emergencies. Members gather information quickly and respond to the crisis while everyone else carries out his or her normal duties. The team also keeps the public, the employees, the press, and government officials informed about the situation and the company's response to it (Perkins, 2000).

An example of how to handle crisis management involves Wendy's. After learning that a woman claimed she found a fingertip in a bowl of chili she bought at a Wendy's restaurant in San Jose, California, the company's public relations team responded quickly. Within a few days, the company announced that the finger came not from an employee or a supplier. Soon after, the police arrested the woman and charged her with attempted grand larceny for lying about how the finger got in her bowl of chili and trying to extort \$2.5 million from the company. But the crisis was not

over for Wendy's. The incident was plastered all over the news as a grossed-out public sought an answer to the question, "Whose finger is (or was) it?" A \$100,000 reward was offered by Wendy's to anyone with information that would help the police answer this question.

Video 1. BP Oil Spill



*A YouTube element has been excluded from this version of the text. You can view it online here:*  
<https://pressbooks.library.upei.ca/startup/?p=536>

([Video Link](#)). The response to the BP oil spill by its former CEO, Tony Hayward, is an example of poor crisis management.

The challenge Wendy's faced was how to entice customers to return to its 50 San Francisco–area restaurants (where sales had plummeted) while keeping a low profile nationally. It accomplished this by giving out free milkshakes and discount coupons to customers in the affected regions and, to avoid calling attention to the missing finger, by making

no changes in its national advertising. The crisis management strategy worked, and the story died down (though it flared up temporarily when the police arrested the woman's husband, who allegedly bought the finger from a coworker who had severed it in an accident months earlier) (Elliott, 2005).

Even with crisis management plans in place, however, it is unlikely that most companies will emerge from a damaging or potentially damaging episode as unscathed as Wendy's did. The culprits in the Wendy's case were caught, and the public will forgive an organization it views as a victim. Given the current public distrust of corporate behaviour, however, companies whose reputations have suffered because of questionable corporate judgement do not fare as well. These companies include the international oil company, BP, whose CEO, Tony Hayward, did a disastrous job handling the crisis created when a BP controlled oil rig exploded in the Gulf Coast, killing 11 workers and creating the largest oil spill in U.S. history. Hayward's lack of sensitivity will be remembered forever; particularly his response to a reporter's question on what he would tell those whose livelihoods were ruined: "We're sorry for the massive disruption it's caused their lives. There is no one who wants this over more than I do. I would like my life back." His comment was obviously upsetting to the families of the 11 men who lost their lives on the rig and had no way to get their lives back (The Times of London, 2010).

Then, there are the companies at which executives have crossed the line between the unethical to the downright illegal, like Arthur Andersen, Enron, and Bernard L. Madoff Investment Securities. Given the high risk associated with a crisis, it should come as no surprise that contemporary managers spend more time expecting crises and practicing their crisis management responses.

## Key Takeaways

Successful managers decide where they want the organization to go and then determine how to get there, especially when facing risks and challenges.

- **Planning** for a business starts at the top and works its way down.
- It begins with **strategic planning**, establishing an overall course of action.
- Step one is identifying the problem and develop goals and objectives.
- Then management is ready to take the remaining steps in developing **tactical plans** and **operational plans** to implement objectives.

## Footnotes

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# 10/ Teams

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Source: [Anna Shvets](#).

## Teamwork in Business

*Learning Objectives*

- Define different teams and describe key characteristics.
- Explain why organizations use teams.
- Identify factors that contribute to team cohesion or division.
- Describe the importance of learning to take part in team-based activities.
- Identify the skills needed by team members and the roles that members of a team might play.
- Explain the skills and behaviours that foster effective team leadership.

## What Is a Team? How Does Teamwork Work?

A team (or a work team) is a group of people with complementary skills who work together to achieve a specific goal.<sup>86</sup>

## Teams Versus Groups

Teams are organized around a shared aim, something to accomplish.

*“Teamwork is the ability to work together toward a common vision. The ability to direct individual accomplishments toward organizational objectives. It is the fuel that allows common people to attain uncommon results.”*

– Andrew Carnegie

A group is distinct. A group of department store managers, for example, might meet monthly to discuss their progress in cutting plant costs. However, each manager is focused on the goals of his or her department because each is held accountable for meeting those goals.

## Some Key Characteristics of Teams

To put teams in perspective, let us identify five key characteristics.<sup>87</sup>

- Share accountability for achieving specific common goals.
- Function interdependently.
- Require stability.
- Hold authority and decision-making power.
- Operate in a social context.

## Why Organizations Build Teams

Why do major organizations now rely so much on teams to improve operations? Executives at Xerox have reported that team-based operations are 30% more productive than conventional operations. General Mills says that factories organized around team activities are 40% more productive than traditionally organized factories. FedEx says that teams reduced service errors (lost packages, incorrect bills) by 13% in the first year.<sup>88</sup>

Today teams can address a variety of challenges in the world of corporate activity. Before we go any further, however, we should remind ourselves that the data we have just cited are not necessarily definitive. They may not be the aim, companies are more likely to report successes than failures.

Teams do not always work. According to one study, team-based projects fail 50% to 70% of the time.<sup>89</sup>

## The Effect of Teams on Performance



SOURCE: [Sebastian Voortman](#).

Research shows that companies build and support teams because of their effect on overall workplace performance, both organizational and individual. If we examine the impact of team-based operations according to a wide range of relevant criteria, we find that overall organizational performance generally improves. The following figure lists several areas in which we can analyze workplace performance and shows the percentage of companies that have reported improvements in each area.

Table 1. Overall Workplace Performance



Area of Performance	Firms Reporting Improvement
Product and service quality	70%
Customer service	67%
Worker satisfaction	66%
Quality of worklife	63%
Productivity	61%
Competitiveness	50%
Profitability	45%
Absenteeism   turnover	23%

Adapted from Lawler, E. E., Mohaman, S. A., & Ledford, G. E. (1992). *Creating high performance organizations: Practices and results of employee involvement and total quality in Fortune 1000 Companies*. San Francisco: Wiley.

## Types of Teams

Teams can improve company and individual performance in several areas. Not all teams, however, are formed to achieve the same goals or charged with the same responsibilities. Nor are they organized in the same way. Some, for instance, are more autonomous than others, less accountable to those higher in the organization. Some depend on a team leader who defines the team's goals and making sure that its activities are performed effectively. Others are self-

governing: though a leader lays out overall goals and strategies, the team itself chooses and manages the methods by which it pursues its goals and implements its strategies.<sup>90</sup> Teams also vary according to their membership. Let us look at several categories of teams.

## Manager-Led Teams

As its name implies, in the manager-led team the manager is the team leader and oversees setting team goals, assigning tasks, and monitoring the team's performance. The individual team members have relatively little autonomy. For example, the key employees of a professional football team (a manager-led team) are highly trained (and highly paid) athletes, but their activities on the field are tightly controlled by a head coach. As team manager, the coach is responsible both for developing the strategies by which the team pursues its goal of winning games and for the outcome of each game and season. They are also solely responsible for interacting with managers above them in the organization. The players mainly execute plays. This hierarchy is consistent in organizations such as firefighting, policing, military, and medicine.<sup>91</sup>



SOURCE: [Pixabay](#).

## Self-Managing Teams

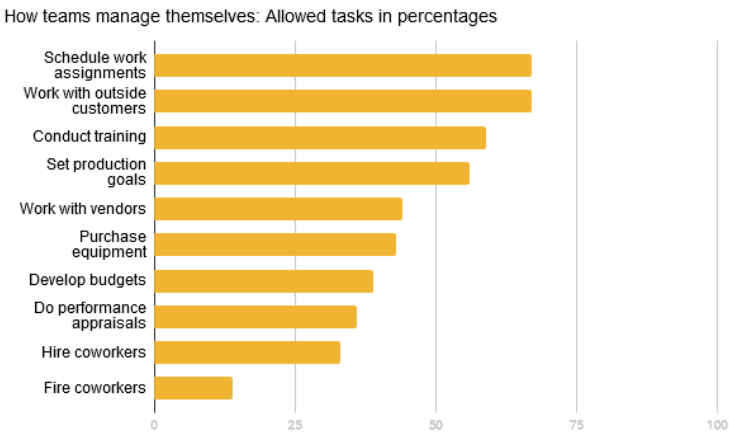
Self-managing teams (also known as self-directed teams) have considerable autonomy. They are usually small and often absorb activities that were once performed by traditional supervisors. A manager or team leader may determine overall goals, but the members of the self-managing team control the activities needed to achieve those goals.

Self-managing teams are the organizational hallmark of Whole Foods Market, the largest natural-foods grocer in the United States. Each store is run by ten departmental teams, and virtually every store employee is a member of a team. Each team has a designated leader and its own performance targets. (Team leaders also belong to a store team, and store team leaders belong to a regional team.) To do its job, every team has access to the information, including sales and even

salary figures that most companies reserve for traditional managers.<sup>92</sup>

Not every self-managed team enjoys the same autonomy. Companies vary widely in choosing which tasks teams can manage and which ones are best left to upper-level management only. As you can see, self-managing teams are often allowed to schedule assignments, but they are rarely allowed to fire coworkers.

Figure 1. How Teams Manage Themselves



## Cross-Functional Teams

Many companies use cross-functional teams that cut across an organization’s functional areas (operations, marketing, finance, and so on). A cross-functional team takes advantage of the special expertise of members drawn from different functional areas of the company. When the Internal Revenue Service, for example, wanted to study the effects on employees of a major change in information systems, it created a cross-functional team composed of people from a wide range of departments. The final study reflected expertise in

such areas as job analysis, training, change management, industrial psychology, and ergonomics.<sup>93</sup>

Cross-functional teams figure prominently in the product development process at Nike, where they take advantage of expertise from both inside and outside the company.



SOURCE: [Fauxels](#).

Typically, team members include not only product designers, marketing specialists, and accountants but also sports-research experts, coaches, athletes, and even consumers. Nike's team was a cross-functional team; responsibility for developing the new product is not passed along from the design team to the engineering team but entrusted to a special team composed of both designers and engineers.

Committees and task forces, both of which are dedicated to specific issues or tasks, are often cross-functional teams. Problem-solving teams, which study such issues as improving quality or reducing waste, may be intradepartmental or cross-functional.<sup>94</sup>

## Virtual Teams



SOURCE: [Olha Ruskykh](#).

Technology now makes it possible for teams to function not only across organizational boundaries like functional areas but also across time and space. Technologies such as videoconferencing allow people to interact simultaneously and in actual time, offering several advantages in conducting the business of a virtual team.<sup>95</sup> Members can take part from any location or time of day, and teams can “meet” for as long as it takes to achieve a goal or solve a problem, a few days, weeks, or months.

Team size does not seem to be an obstacle with virtual team meetings; in building the F-35 Strike Fighter, U.S. defence contractor Lockheed Martin staked the \$225 billion project on a virtual product-team of unprecedented global dimension, drawing on designers and engineers from the ranks of eight international partners from Canada, the United Kingdom, Norway, and Turkey.<sup>96</sup>

# Why Teamwork Works

Now that we know a bit about how teams work, we need to ask ourselves why they work. This is a complex issue. In this section, we'll explore why teams are often effective and when they are ineffective.

## Factors in Effective Teamwork

Let us begin by identifying several factors that contribute to effective teamwork. Teams are most effective when the following factors are met:

- Members communicate effectively.

- Members depend on each other. When team members rely on each other to get the job done, team productivity and efficiency tend to be high.

- Members trust one another.

- Members work better together than individually. When team members perform better as a group than alone, collective performance exceeds individual performance.

- Members become boosters. When each member is encouraged by other team members to do his or her best, collective results improve.

- Team members enjoy being on the team.

- Leadership rotates.

Some of these factors may seem intuitive. Because such issues are rarely clear-cut, we need to examine group effectiveness from another perspective, one that considers the effects of factors that are not so straightforward.

## Group Cohesiveness

The idea of group cohesiveness refers to the attractiveness of a team to its members. If a group is high in cohesiveness, membership is quite satisfying to its members. If it is low in cohesiveness, members are unhappy with it and may try to leave it.<sup>97</sup>



SOURCE: [Designecologist](#).

## What Makes a Team Cohesive?

Many factors may contribute to team cohesiveness, but in this section, we will focus on five of the most important:

**Size.** The bigger the team, the less satisfied members tend to be. When teams get too large, members find it harder to interact closely with other members; a few members tend to dominate team activities, and conflict becomes more likely.

**Similarity.** People usually get along better with people



like themselves, and teams are generally more cohesive when members perceive fellow members as people who share their own attitudes and experience.

**Success.** When teams are successful, members are satisfied, and other people are more likely to be attracted to their teams.

**Exclusiveness.** The harder it is to get into a group, the happier the people who are already in it. Team status also increases members' satisfaction.

**Competition.** Membership is valued more highly when there is motivation to achieve common goals and outperform other teams.

Maintaining team focus on broad organizational goals is crucial. If members get too wrapped up in immediate team goals, the entire team may lose sight of the larger organizational goals toward which it's supposed to be working. Let us look at some factors that can erode team performance.

## **Groupthink**

It is easy for leaders to direct members toward team goals when members are all on the same page, when there is a basic willingness to conform to the team's rules. When there is too much conformity, however, the group can become ineffective: it may resist fresh ideas and, what is worse, may end up adopting its own dysfunctional tendencies as its way of doing things. Such tendencies may also encourage a phenomenon known as groupthink, the tendency to conform to group pressure in decisions, while failing to think critically or to consider outside influences.

Groupthink is often cited as a factor in the explosion of the space shuttle Challenger in January 1986: engineers from a supplier of components for the rocket booster warned that the launch might be risky because of the weather but were

persuaded to set aside their warning by NASA officials who wanted the launch to proceed as scheduled.<sup>98</sup>



SOURCE: [Nataliya](#).

## Motivation and Frustration

Remember that teams are composed of people, and whatever the roles they are playing at a time, people are subject to psychological difficulties. As members of workplace teams, they need motivation, and when motivation is low, so are effectiveness and productivity. The difficulty of maintaining a high-level of motivation is the chief cause of frustration among members of teams. It is also a chief cause of ineffective teamwork, and that is one reason more employers now look for the ability to develop and sustain motivation when they're hiring new managers.<sup>99</sup>

## Other Factors that Erode Performance

Let us take a quick look at three other obstacles to success in introducing teams into an organization:<sup>100</sup>

Unwillingness to cooperate. Failure to cooperate can occur when members do not or will not commit to a common goal or set of activities. What if, for example, half the members of a product development team want to create a brand-new product and half want to improve an existing product? The entire team may get stuck on this point of contention for weeks or even months. Lack of cooperation between teams can also be problematic to an organization.

Lack of managerial support. Every team requires organizational resources to achieve its goals, and if management is not willing to commit the needed resources (i.e. funding or key personnel) a team will probably fall short of those goals.

Failure of managers to delegate authority. Team leaders are often chosen from the ranks of successful supervisors, first-line managers give instructions on a day-to-day basis and expect to have them carried out. This approach to workplace activities may not work very well in leading a team, a position in which success depends on building a consensus and letting people make their own decisions.

## The Team and Its Members



SOURCE: [SplitShire](#).

*"I'll work extra hard and do it myself, but please don't make me have to work in a group."*

Like it or not, you've probably already notice that you will have team-based assignments in college. Over 66% of all students' report having taken part in the work of an organized team, and if you are in business school, you will almost certainly find yourself engaged in team-based activities.<sup>101</sup>

Why do we put so much emphasis on something that, reportedly, makes many students feel anxious and academically drained? Here is one college student's practical-minded answer to this question:

*"In the real world, you have to work with people. You don't always know the people you work with, and you don't always get along with them. Your boss won't particularly care, and if you can't get the job done, your job may end up on the line. Life is all about group work, whether we like it or not. And school, in many ways, prepares us for life, including working with others."*<sup>102</sup>

She is right. Placing so much emphasis on teamwork skills and experience, business colleges are doing the responsible thing like preparing students for the business

world. A survey of Fortune 1000 companies reveals that 79% use self-managing teams and 91% use other forms of employee work groups. Another survey found that the skill that most employers value in new employees is the ability to work in teams.<sup>103</sup> Consider the advice of former Chrysler Chairperson Lee Iacocca: “A major reason that capable people fail to advance is that they don’t work well with their colleagues”.<sup>104</sup> The importance of the ability to work in teams was confirmed in a survey of leadership practices of over 60 of the world’s top organizations.<sup>105</sup>

When top executives in these organizations were asked what causes the careers of high-potential leadership candidates to derail, 60% of the organizations cited “inability to work in teams.” Interestingly, only 9% attributed failing to advance was a “lacking technical ability.” To put it in plain terms, the question is not whether you will work as part of a team. You will. The question is whether you will know how to take part successfully in team-based activities.

## **Will You Make a Good Team Member?**

What if your instructor divides the class into teams and assigns each team to develop a new product plus a business plan to get it on the market? What teamwork skills could you bring to the table, and what teamwork skills do you need to improve? Do you possess qualities that might make you an excellent team leader?

## **What Skills Does the Team Need?**

Sometimes we hear about a sports team made up of mostly average players who win a championship because of

coaching genius, flawless teamwork, and superhuman determination.<sup>106</sup> But not terribly often. In fact, we usually hear about such teams simply because they are newsworthy exceptions to the rule. Typically, a team performs well because its members possess some level of talent.

A team can succeed only if its members provide the skills that need managing, which requires some mixture of four sets of skills:

Communication Skills. Because how you communicate can positively and negatively affect relationships within the team and outside the team with managers, customers, vendors, etc.

Technical skills. Because teams must perform certain tasks, they need people with the skills to perform them. For example, if your project calls for a lot of math work, it is good to have someone with the necessary quantitative skills.

Decision-making and problem-solving skills. Because every task is subject to problems, and because handling every problem means deciding on the best solution, it is good to have members who are skilled in identifying problems, evaluating alternative solutions, and deciding on the best options.

Interpersonal skills. Because teams need direction and motivation and depend on communication, every group benefits from members who know how to listen, provide feedback, and resolve conflict. Some members must also be good at communicating the team's goals and needs to outsiders.

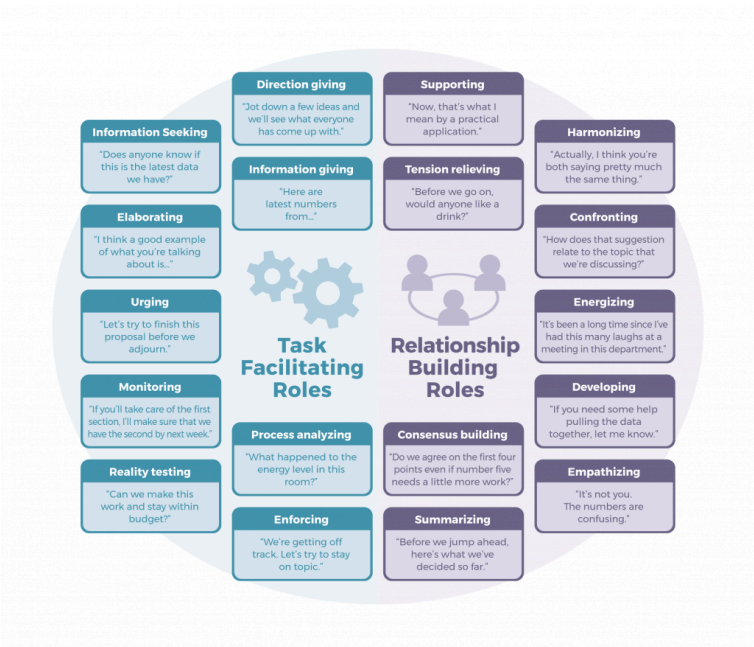
The key is ultimately to have the right mix of these skills. Remember, too, that no team needs to possess all these skills from day one. Most times, a team gains certain skills only when members volunteer for certain tasks and perfect their skills in performing them. For the same reason, effective teamwork develops over time as team members learn how to

handle various team-based tasks. Teamwork is always a work in progress.

## What Roles Do Team Members Play?

As a student and later in the workplace, you will be a member of a team more often than a leader. Team members can have as much impact on a team’s success as its leaders. A key is the quality of the contributions they make in performing non-leadership roles.<sup>107</sup>

Figure 2. Teamwork



What, exactly, are those roles? You have probably concluded that every team faces two basic challenges:

Accomplishing its assigned task

Maintaining or improving group cohesiveness

Whether you affect the team’s work positively or

negatively depends on the extent to which you help it or hinder it in meeting these two challenges.<sup>108</sup> We can divide teamwork roles into two categories, (task-facilitating roles and relationship-building roles) see Figure above ([link](#)).

## Task-Facilitating Roles

Task-facilitating roles address the critical challenge of accomplishing the team goals. As you can see from Table P.6, such roles include not only providing information when someone else needs it but also asking for it when you need it. In addition, it includes monitoring (checking on progress) and enforcing (making sure that team decisions are carried out). Task facilitators are especially valuable when assignments are not clear or when progress is too slow.



SOURCE: [Ron Lach](#).



## Relationship-Building Roles

When you challenge unmotivated behaviour or help other team members understand their roles, you are performing a relationship-building role and addressing the second challenge of maintaining or improving group cohesiveness. This type of role includes activities that improve team “chemistry,” from empathizing to confronting.

Remember three points about this model:

- Teams are most effective when there is a good balance between task facilitation and relationship-building.
- It is hard for any member to perform both types of roles, as some people are better at focusing on tasks and others on relationships.
- Overplaying any facet of any role can easily become counterproductive. For example, elaborating on something may not be the best strategy when the team needs to make a quick decision; and consensus building may cause the team to overlook an important difference of opinion.

## Blocking Roles

Finally, show what you know to block behaviours and the tactics used when someone is using the behaviour. So-called blocking roles comprise behaviour that inhibits either team performance or that of individual members. Every member of the team should know how to recognize blocking behaviour. If teams do not confront dysfunctional members, they can destroy morale, hamper consensus building, create conflict, and hinder progress.



An interactive or media element has been excluded from this version of the text. You can view it online here: [link](#).

## Class Team Projects

In your academic career you will take part in several team projects. To get insider advice on how to succeed on team projects in college, let us look at some suggestions offered by students from their experience.<sup>109</sup>

Draw up a team charter. At the beginning of the project, draw up a team charter that includes: the goals of the group; ways to ensure that each team member's ideas are considered; timing and frequency of meeting. A more informal way to arrive at a team charter is to set some ground rules to which everyone agrees. Your instructor may also require you to sign an existing team contract or charter like the one below.

Contribute your ideas. Share your ideas with your group. The worst that could happen is that they will not be used (which is what would happen if you kept quiet).

Never miss a meeting or deadline. Pick a weekly meeting time and write it into your schedule as if it were a class. Never skip it.

Be considerate of each other. Be patient, listen to everyone, involve everyone in decision-making, avoid infighting, build trust.

Create a process for resolving conflict. Do so before conflict arises. Set up rules to help the group decide how conflict will be handled.

Use the strengths of each team member. All students bring different strengths. Use the unique value of each person.

Do not do all the work yourself. Work with your team

to get the work done. The project output is often less important than the experience.

## What Does It Take to Lead a Team?

To borrow from Shakespeare, “Some people are born leaders, some achieve leadership, and some have leadership thrust upon them.” In a successful career, you will probably be asked to lead a team. What will you have to do to succeed as a leader?

Like so many of the questions that we ask in this book, this question does not have any simple answers. We can provide one broad answer: a leader must help members develop the attitudes and behaviour that contribute to team success: interdependence, collective responsibility, shared commitment, and so forth.

Team leaders must be able to influence their team members. Notice that we say influence: except in unusual circumstances, giving commands and controlling everything directly does not work very well.<sup>110</sup> As one team of researchers puts it, team leaders are more effective when they work with members rather than on them.<sup>111</sup> Hand-in-hand with the ability to influence is the ability to gain and keep the trust of team members. People are not likely to be influenced by a leader whom they perceive as dishonest or selfishly motivated.

Assuming you were asked to lead a team, there are certain leadership skills and behaviours that would help you influence your team members and build trust. Let us glance at some of them:

Show integrity. Do what you say you will do and act under your stated values. Be honest in communicating and follow through on promises.

Be clear and consistent. Let members know you are

certain about what you want and remember that being clear and consistent reinforces your credibility.

Generate positive energy. Be optimistic and compliment team members. Recognize their progress and success.

Acknowledge common points of view. Even if you are about to propose change, recognize the value of the views that members already hold in common.

Manage agreement and disagreement. When members agree with you, confirm your shared point of view. When they disagree, acknowledge both sides of the issue and support your own with strong, clearly presented evidence.

Encourage and coach. Buoy up members when they run into new and uncertain situations and when success depends on their performing at a high-level.

Share information. Give members the information they need and let them know you are knowledgeable about team tasks and individual talents. Check with team members regularly to find out what they are doing and how the job is progressing.

A team contract is important to ensure all members have input on how the team will work together. This contract can also be referenced if a team member is not working to their expectations.



An interactive or media element has been excluded from this version of the text. You can view it online here: [link](#).

### *Key Takeaways*

A team (or a work team) is a group of people with complementary skills and diverse areas of expertise who work together to achieve a specific goal.

Work teams have five key characteristics:

1. Accountable for achieving specific common goals.
2. Function interdependently.
3. Stable.
4. Have authority.
5. Operate in a social context.

Work teams may be of several types:

- In the traditional manager-led team, the leader defines the team's goals and activities and achieves its assigned goals.
- The leader of a self-managing team may determine overall goals, but employees control the activities needed to meet them.
- A cross-functional team takes advantage of the special expertise of members drawn from different functional areas of the company.
- On virtual teams, geographically dispersed members interact electronically while pursuing a common goal.

Group cohesiveness refers to the attractiveness of a team to its members. If a group is high in cohesiveness, membership is quite satisfying to its members; if it is low in cohesiveness, members are unhappy with it and may even try to leave it.

As the business world depends more and more on teamwork, it is increasingly important for incoming members of the workforce to develop skills and experience in team-based activities.

Every team requires some mixture of three skill sets:

1. Technical skills: skills needed to perform specific tasks.
2. Decision-making and problem-solving skills: skills needed to identify problems, evaluate alternative solutions, and decide on the best options.
3. Interpersonal skills: skills in listening, providing feedback, and resolving conflict.

## The Cultural Environment

Even when two people from the same country communicate, there is always a possibility of misunderstanding. When people from different countries get together, that possibility increases substantially. Differences in communication styles reflect differences in culture: the system of shared beliefs, values, customs, and behaviours that govern the interactions of members of a society. Cultural differences create challenges in successful international business dealings. Let us look at a few of these challenges.

## Language

English is the international language of business. The natives of such European countries as France and Spain certainly take pride in their own languages and cultures, English is the business language of the European community.

Whereas only a few educated Europeans have studied Italian or Norwegian, most have studied English. Similarly, on the South Asian subcontinent, where hundreds of local languages and dialects are spoken, English is the official language. In most corners of the world, English-only speakers (most Canadians) have no problem finding competent translators and interpreters. So why is language an issue for English speakers doing business in the global marketplace? In many countries, only members of the educated classes speak English. The larger population (usually the market you want to tap) speaks the local tongue. Advertising messages and sales appeals must take this into account. Multiple English translations of an advertising slogan can cause a humorous (and perhaps serious) blunder.

## Lost in Translation

In Belgium, the translation of the slogan of an American auto-body company, *Body by Fisher*, came out as *Corpse by Fisher*.

Translated into German, the slogan, *Come Alive with Pepsi* became *Come Out of the Grave with Pepsi*.

A U.S. computer company in Indonesia translated “software” as “underwear”.

A German chocolate product called “Zit” did not sell well in the U.S.

An English-speaking car wash company in Francophone

Quebec advertised itself as a “lavement d’auto” or “car enema” instead of the correct “lavage d’auto.”

In the 1970s, General Motors’ Chevy Nova did not get on the road in Puerto Rico, in part because “nova” in Spanish means “it doesn’t go”.



SOURCE: [Ketut Subiyanto](#).

Relying on translators and interpreters puts you as an international businessperson at a disadvantage. You are privy only to interpretations of the messages that you are getting, and this handicap can cause a real competitive problem. Maybe you will misread the subtler intentions of the person with whom you are trying to conduct business. The best way to combat this problem is to study foreign languages. Most people appreciate some effort to communicate in their local language, even on the most basic level. They even appreciate mistakes you make resulting from a desire to show your genuine interest in the language of your counterparts in foreign countries. The same principle goes double when you are introducing yourself to non- English speakers in Canada. Few things work faster to encourage a friendly atmosphere



than a native speaker's willingness to greet a foreign guest in the guest's native language.

## **Time and Sociability**

North American people take many of the cultural aspects of our business practices for granted. Our meetings for instance, focus on business issues, and we tend to start and end our meetings on schedule. These habits stem from a broader cultural preference: we dislike wasting time (It was an American, Benjamin Franklin, who coined the phrase "Time is money"). This preference, however, is not universal. The expectation that meetings will start on time and adhere to precise agendas is common in parts of Europe (especially the Germanic countries), as well as in Canada, but elsewhere (i.e. Latin America and the Middle East) people are often late to meetings.

## **High- and Low-Context Cultures**

Likewise, do not expect businesspeople from these regions (or businesspeople from most of Mediterranean Europe) to "get down to business" as soon as a meeting has started. They will probably ask about your health and that of your family, inquire whether you are enjoying your visit to their country, suggest local foods, and generally appear to be avoiding serious discussion at all costs. For Canadians, such topics are conducive to nothing but idle chitchat, but in certain cultures, getting started this way is a matter of simple politeness and hospitality.

# Intercultural Communication

Different cultures have different communication styles, a fact that can take some getting used to. For example, degrees of animation in expression can vary from culture to culture. Southern Europeans and Middle Easterners are quite animated, favouring expressive body language along with hand gestures and raised voices. Northern Europeans are far more reserved. The English, for example, are famous for their understated style and the Germans for their formality in most business settings. In addition, the distance at which one feels comfortable when talking with someone varies by culture. People from the Middle East like to converse from a foot or fewer, while North American people prefer more personal space.

Finally, while people in some cultures prefer to deliver direct, simple messages, others use language that is subtler or more indirect. North Americans and most Northern Europeans fall into the former category, and many Asians into the latter. But even within these categories, there are differences. Though typically polite, Chinese and Koreans are extremely direct in expression, while Japanese are indirect: They use vague language and avoid saying “no” even if they do not intend to do what you ask. They worry that turning someone down will cause their “losing face” (i.e. embarrassment or loss of credibility) and so they avoid doing this in public.

In summary, learn about a country’s culture and use your knowledge to help improve the quality of your business dealings. Learn to value the subtle differences among cultures, but do not allow cultural stereotypes to dictate how you interact with people from any culture. Treat each person as an individual and get to know what he or she is about.

# The Organization Chart

Once an organization has set its structure, it can represent that structure in an organization chart: a diagram delineating the interrelationships of positions within the organization. Here is an example of this type of organization chart:

Figure 3. Potential organization chart for the Note-4-You company

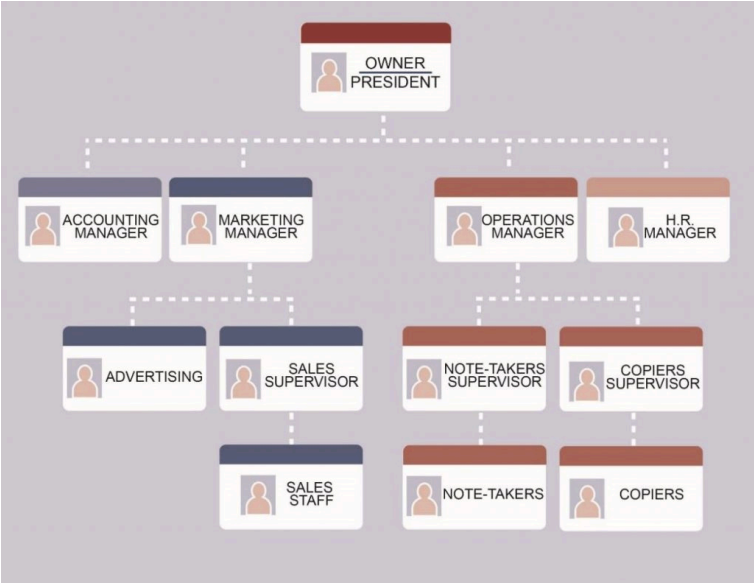
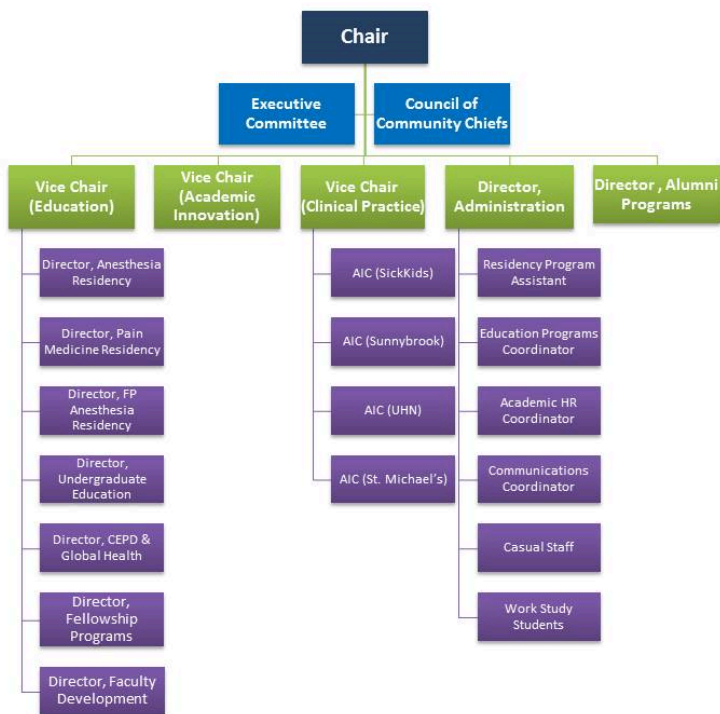


Figure 4. Advanced Organizational Structure



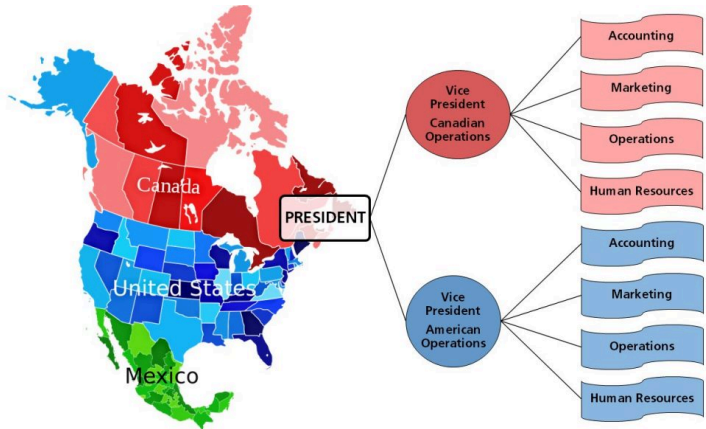
Imagine putting yourself at the top of the chart, as the company's president. You would then fill in the level directly below your name with the names and positions of the people who work directly for you like your accounting, marketing, operations, and human resources managers. The next level identifies the people who work for these managers. Because you have started out small, neither your accounting manager nor your human resources manager will be currently managing anyone directly. Your marketing manager, however, will oversee one person in advertising and a sales supervisor (who oversees the sales staff). Your operations manager will oversee two individuals, one to supervise note-takers and one to supervise the people responsible for making copies. The lines between the positions on the chart show the reporting

relationships; for example, the Note-Takers Supervisor reports directly to the Operations Manager.

Although the structure suggests that you will communicate only with your four direct reports, this is not the way things normally work in practice. Behind every formal communication network there lies a network of informal communications, unofficial relationships among members of an organization. You might find that over time, you receive communications directly from members of the sales staff; in fact, you might encourage this line of communication.

Now let us look at the chart of an organization that relies on a divisional structure. Educational institutions are a good example, either as a whole or even at the departmental level. Use the one below as an example or look at your own institution's organization chart. Many companies with a divisional structure organize by product, services, or customer base. Educational institutions reflect a mix of those divisional structure options.

Figure 5. Global Organizational Chart



Over time, companies revise their organizational structures to accommodate growth and changes in the external environment. It is not uncommon, for example, for a firm to adopt a functional structure in its early years. Then,

as it becomes bigger and more complex, it might move to a divisional structure, perhaps to accommodate new products or to become more responsive to certain customers or geographical areas. Some companies might ultimately rely on a combination of functional and divisional structures. This could be a friendly approach for a credit card company that issues cards in both the United States and Canada. An outline of this firm's organization chart might look like the following diagram.

## Chain of Command

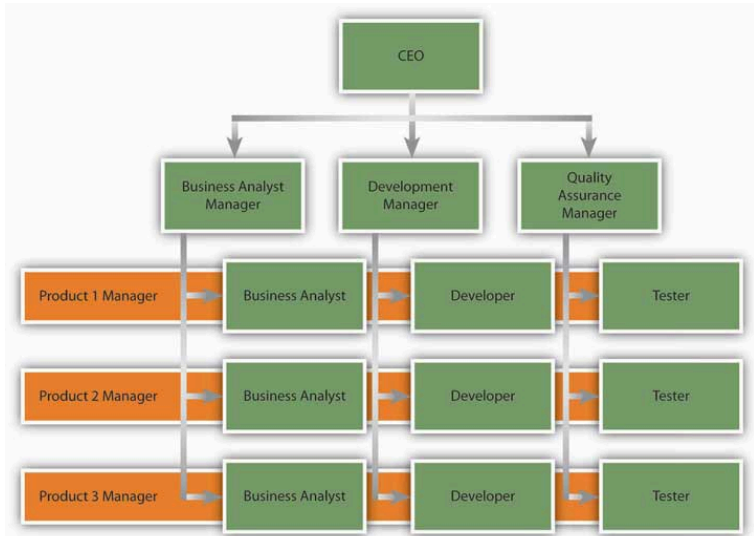
The vertical connecting lines in the organization chart show the firm's chain of command: the authority relationships among people working at different levels of the organization. They show who reports to whom. When you are examining an organization chart, you will probably want to know whether each person reports to one or more supervisors: to what extent is there unity of command? To understand why unity of command is an important organizational feature, think about it from a personal standpoint. Would you want to report to multiple bosses? What happens if you get conflicting directions? Whose directions would you follow?

There are, however, conditions under which an organization and its employees can benefit by violating the unity of command principle. Under a matrix structure, for example, employees from various functional areas (product design, manufacturing, finance, marketing, human resources, etc.) form teams to combine their skills in working on a specific project or product. This matrix organization chart might look like the one in the following figure.

Nike sometimes uses this type of arrangement. To design new products, the company may create product teams made up of designers, marketers, and other specialists with

expertise in sports categories, like running shoes or basketball shoes. Both the team manager and the head of his or her functional department would evaluate each team member.

Figure 6. Organizational Matrix



<https://courses.lumenlearning.com/principlesmanagement/chapter/7-3-contemporary-forms-of-organizational-structures/>

## Span of Control

Another thing to notice about a firm's chain of command is the number of layers between the top managerial position and the lowest managerial level. New organizations have only a few layers of management, an organizational structure that is often called flat. Let us say, for instance, that a member of the Notes-4-You sales staff wanted to complain about slow sales among a certain group of students. That person's message would have to filter upward through only two management layers (the sales supervisor and the marketing manager) before reaching the president.

As a company grows, it adds more layers between the top and the bottom. Added layers of management can slow down communication and decision-making, causing the organization to become less efficient and productive. That is one reason many of today's organizations are restructuring to become flatter.

There are trade-offs between the advantages and disadvantages of flat and tall organizations. Companies determine which trade-offs to make according to a principle called span of control, which measures the number of people reporting to a particular manager. If, for example, you remove layers of management to make your organization flatter, you end up increasing the number of people reporting to a particular supervisor. If you refer to the organization chart for Notes-4-You, you'll recall that, under your present structure, four managers report to you as the president: the heads of accounting, marketing, operations, and human resources. Two of these managers have positions reporting to them: the advertising manager and sales supervisor report to the marketing manager, while the note-takers supervisor and the copiers supervisor report to the operations manager. Let us say that you remove a layer of management by getting rid of the marketing and operations managers. Your organization would be flattened, but what would happen to your workload? As president, you would now have six direct reports rather than four: accounting manager, advertising manager, sales manager, note-taker supervisor, copier supervisor, and human resources manager.

What is better? A narrow span of control (with few direct reports) or a wide span of control (with many direct reports)? The answer to this question depends on several factors, including frequency and type of interaction, proximity of subordinates, competence of both supervisor and subordinates, and the nature of the work being supervised. For



example, you would expect a much wider span of control at a non-profit call centre than in a hospital emergency room.

## **Delegating Authority**

Given the tendency toward flatter organizations and wider spans of control, how do managers handle increased workloads? They must learn how to handle delegation, entrusting work to subordinates. Unfortunately, many managers are reluctant to delegate. As a result, they not only overburden themselves with tasks that others could handle, but they also deny subordinates the opportunity to learn and develop new skills.

## **Responsibility and Authority**

As owner of Notes-4-You, you will probably want to control every aspect of your business, especially during the startup stage. But as the organization grows, assign responsibility for performing certain tasks to other people. You will also have to accept the fact that responsibility alone (the duty to perform a task) will not be enough to get the job done. You will need to grant subordinates the authority they require completing a task, such as the power to decide (they will also need sufficient resources). Ultimately, you will hold your subordinates accountable for their performance.

## **Centralization and Decentralization**

If/when your company expands (i.e. offering note-taking services at other schools), decide whether most

individuals should still make decisions at the top or delegated to lower-level employees. The first option, in which most decision-making is concentrated at the top – **centralization**. The second option, which spreads decision-making throughout the organization, is **decentralization**.

Centralization has the advantage of consistency in decision-making. The same top managers make key decisions in a centralized model, which tend to be more uniform than if decisions were made by a variety of different people at lower levels in the organization. In most cases, decisions can also be made more quickly provided that top management does not control too many decisions. There are disadvantages to centralization, including if top management makes virtually all key decisions, then lower-level managers will feel under-used and will not develop decision-making skills that would help them become promotable. An overly centralized model cannot consider information that only front-line employees have or might delay the decision-making process. Consider a case where the sales manager for an account is meeting with a customer representative who makes a request for a special sale price; the customer offers to buy 50% more product if the sales manager will reduce the price by 5% for one month. If the sales manager had to get approval from the head office, the opportunity might disappear before she could get approval, a competitor's sales manager might be the customer's next meeting.

An overly decentralized decision model has its risks as well. Imagine a case in which a company had adopted a geographically based divisional structure and had decentralized decision-making. To expand its business, suppose one division expanded its territory into the geography of another division. If headquarters approval for such a move was not required, the divisions of the company might end up competing against each other, to the detriment of the organization. Companies that wish to maximize their potential

must find the right balance between centralized and decentralized decision-making.

### *Key Takeaways*

Managers coordinate the activities identified in the planning process among individuals, departments, or other units and allocate the resources needed to perform them.

Typically, there are three levels of management: top managers, who handle overall performance; middle managers, who report to top managers and oversee lower-level managers; and first-line managers, who supervise employees to ensure work is performed correctly and on time.

Management must develop an organizational structure, or arrangement of people within the organization, that will best achieve company goals.

The process begins with specialization by dividing necessary tasks into jobs; the principle of grouping jobs into units is called departmentalization.

Units are then grouped into an appropriate organizational structure. Functional organization groups people with comparable skills and tasks; divisional organization creates a structure composed of self-contained units based on product, customer, process, or geographical

division. Forms of organizational division are often combined.

An organization's structure is represented in an organization chart, a diagram showing the interrelationships of its positions.

- This chart highlights the chain of command, or authority relationships among people working at different levels.
- It also shows the number of layers between the top and lowest managerial levels. An organization with few layers has a wide span of control, with each manager overseeing many subordinates; with a narrow span of control, only a few subordinates reports to each manager.

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# 11/ Human Resources

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SOURCE: [Artem Podrez](#).

## Human Resources

*Learning Objectives*

Define human resource management and



explain how managers develop and implement a human resource plan.

Explain how companies train and develop employees and discuss the importance of a diverse workforce.

Identify factors that make an organization a good place to work, including competitive compensation and benefits packages.

Explain how managers evaluate employee performance and keep qualified employees.

## Show What You Know



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## The Grounds of a Great Work Environment

Starbucks Founder [Howard Schultz](#) has vivid memories of his father slumped on the couch with his leg in a cast.<sup>112</sup> The ankle would heal, but his father had lost another job, this time as a driver for a diaper service. It was a crummy job; still, it put food on the table, and if his father could not work, there would not be any money. Howard was seven, but he understood the gravity of the situation, particularly because his mother was seven months pregnant, and the family had no insurance.



[“Original Starbucks, Seattle”](#) by [Cory M. Grenier](#) is licensed under [CC BY-SA 2.0](#)

This was just one of the many setbacks that plagued Schultz’s father throughout his life, an honest, hard-working man frustrated by a system that was not designed to cater to the needs of common workers. He held a series of blue-collar jobs (cab driver, truck driver, factory worker), sometimes holding two or three at a time. Despite his willingness to work, he never earned enough money to move his family out of Brooklyn’s federally subsidized housing projects. Schultz’s father died never having found fulfillment in his worklife, or even a meaningful job. It was the saddest day of Howard’s life.

As a kid, did Schultz ever imagine that one day he would be the founder and chairperson of Starbucks Coffee Company? Of course not. He decided that if he could ever make a difference in the lives of people like his father, he would do what he could. Remembering his father’s struggles and disappointments, Schultz has tried to make Starbucks the company where he wished his father had worked. “Without even a high school diploma,” Schultz admits, “my father

probably could never have been an executive. But if he had landed a job in one of our stores or roasting plants, he would not have quit in frustration because the company did not value him. He would have had wonderful health benefits, stock options, and an atmosphere in which his suggestions or complaints would receive a prompt, respectful response.”<sup>113</sup>

Schultz is motivated by both personal and business considerations: “When employees have self-esteem and self-respect,” he argues, “they can contribute so much more: to their company, to their family, to the world.”<sup>114</sup> His commitment to his employees is embedded in Starbucks’s mission statement, whose first aim is to “provide a great work environment and treat each other with respect and dignity.”<sup>115</sup> Those working at Starbucks are called partners because Schultz believes working for his company is not just a job, it’s a passion.<sup>116</sup>

## Point to Ponder

In April 2018, two black men were arrested for trespassing in a Philadelphia Starbucks. They had ordered nothing as they were waiting on a friend. Employees asked them to leave and when they did not, the police were called. Starbucks refrained from pressing charges and the men were released. The incident sparked debate and criticism of Starbucks, which triggered an apology from the company and closed all stores nationwide on May 29th for all employees to take diversity training.

## Human Resource Management

Employees at Starbucks are vital to the company’s

success. They are its public face, and every dollar of sales passes through their hands.<sup>117</sup> According to Howard Schultz, they can make or break the company. If a customer has a positive interaction with an employee, the customer will come back. If an encounter is negative, the customer is probably gone for good. That is why it is crucial for Starbucks to recruit and hire the right people, train them properly, motivate them to do their best, and encourage them to stay with the company. The company works to provide satisfying jobs, a positive work environment, appropriate work schedules, and fair compensation and benefits. These activities are part of Starbucks's strategy to deploy human resources to gain competitive advantage. The process is called **human resource management (HRM)**, which comprises all actions that an organization takes to attract, develop, and keep quality employees. Each of these activities is complex. Attracting talented employees involves the recruitment of qualified candidates and the selection of those who best fit the organization's needs. Development encompasses both new employee orientation and the training and development of current workers. Keeping excellent employees means motivating them to excel, appraising their performance, compensating them appropriately, and doing what is possible to keep them.

## Human Resource Planning

How does Starbucks make sure that its worldwide retail locations are staffed with just the right number of committed employees? How does Norwegian Cruise Line make certain that when the Norwegian Dawn pulls out of New York harbour, it has a complete, fully trained crew on board to feed, entertain, and care for its passengers? Managing these tasks is a matter of strategic human resource planning,

developing a plan for satisfying an organization's human resources (HR) needs.

A strategic HR plan lays out the steps that an organization will take to ensure that it has the right number of employees with the right skills in the right places at the right times. HR managers begin by analyzing the company's mission, objectives, and strategies. Starbucks's objectives, for example, include the desire to "develop enthusiastically satisfied customers" as well as to foster an environment in which employees treat both customers and each other with respect.<sup>118</sup> Thus, the firm's HR managers look for people who are "adaptable, self-motivated, passionate, creative team members."<sup>119</sup> The main goal of Norwegian Cruise Line, to lavish passengers with personal attention, determines not only the type of employee desired (one with exceptionally good customer-relation skills and a strong work ethic) but also the number needed (one for every two passengers on the Norwegian Dawn).<sup>120</sup>

## Job Analysis

To develop an HR plan, HR managers must be knowledgeable about the jobs that the organization needs performed. They organize information about a job by performing a job analysis to identify the tasks, responsibilities, and skills that it entails, as well as the knowledge and abilities needed to perform it. Managers also use the information collected for the job analysis to prepare two documents:

A job description, which lists the duties and responsibilities of a position.

A job specification, which lists the qualifications (skills, knowledge, and abilities) needed to perform the job.

# HR Supply and Demand Forecasting

Once they have analyzed the jobs within the organization, HR managers must forecast future hiring (or firing) needs. This is the three-step process summarized below.

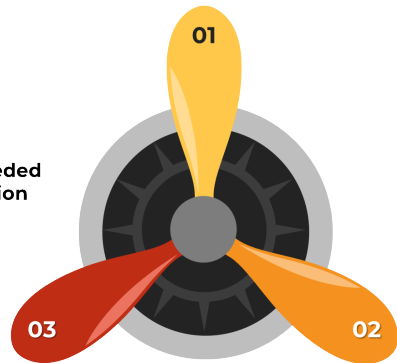
Starbucks, for instance, might find that it needs 300 new employees to work at stores scheduled to open in the next few months. Disney might determine that it needs 2,000 new cast members to handle an expected surge in visitors. The Norwegian Dawn might be short two dozen restaurant workers because of an unexpected increase in reservations.

Figure 1. How to Forecast Hiring (and Firing) Needs

**Identify the human resources currently available in the organization**

**Forecast the human resources needed to achieve the organization's mission and objectives**

**Measure the gap between the two**



After calculating the disparity between supply and future demand, HR managers must draw up plans for bringing the two numbers into balance. If the demand for labour is going to outstrip the supply, they may hire more workers, encourage current workers to put in extra hours, subcontract work to other suppliers, or introduce labour saving initiatives. If the supply is greater than the demand, they may deal with overstaffing by not replacing workers who leave, encouraging early retirements, laying off workers, or (as a last resort) firing workers.

# Recruiting Qualified Employees

Armed with information on the number of new employees to be hired and the positions to be filled, the HR manager then develops a strategy for recruiting potential employees. Recruiting is identifying suitable candidates and encouraging them to apply for openings in the organization.

Before going any further, we should point out that in recruiting and hiring, managers must comply with anti-discrimination laws; violations can have legal consequences. Discrimination occurs when a person is treated unfairly based on a characteristic unrelated to ability. Under Section 3 of the [Canadian Human Rights Act](#), it's illegal to discriminate because of:

*“Race, national or ethnic origin, colour, religion, age, sex, sexual orientation, gender identity or expression, marital status, family status, genetic characteristics, disability or conviction for an offence for which a pardon has been granted or in respect of which a record suspension has been ordered.”*

The Canadian Human Rights Commission and Canada's Charter of Rights and Freedoms protects and enforces several federal employment laws and protects each Canadian's right to equal treatment under the law, including:

- **Equal Pay:** Section 11 of the CHRA which protects male and female employees who do substantially equal work from a difference in wages.
- **Other Factors:** Section 15(1) of the Charter protects every Canadian's right to equal treatment regarding employment regardless of race, national or ethnic origin, colour, religion, sex, age or mental or physical disability.

In Canada, each jurisdiction (3 territories and 10

provinces) is governed by its own Human Rights Code, or a version of it which offers its citizens an additional layer of protection against discriminatory practices. For example, in Ontario it is the Ontario Human Rights Act.

The Employment Equity Act of 1986 identifies specific populations which are protected from discrimination (women, visible minorities, indigenous peoples, and people with disabilities). Individuals who feel that they have been discriminated against can take their case to the Canadian Human Rights Tribunal. Other legislation includes the Canadian Human Rights Act and the Canadian Labour code.

## Where to Find Candidates

The first step in recruiting is to find qualified candidates. Where do you look for them, and how do you decide whether they are qualified? Companies must assess not only the ability of a candidate to perform the duties of a job, but also whether he or she is a good “fit” for the company (i.e. how well the candidate’s values and interpersonal style match the company’s values and culture).

## Internal Versus External Recruiting

Where do you find people who satisfy so many criteria? Basically, you can look in two places: inside and outside your own organization. Both options have pluses and minuses. Hiring internally sends a positive signal to employees that they can move up in the company, a strong motivation tool and a reward for excellent performance. In addition, because an internal candidate is a known quantity, it is easier to predict his or her success in a new position. Finally, it is cheaper to



recruit internally. You will probably have to fill the promoted employee's position. Going outside gives you an opportunity to bring fresh ideas and skills into the company. It is often the only alternative, especially if no one inside the company has just the right combination of skills and experiences. Entry-level jobs are usually filled from the outside.

## How to Find Candidates

Whether you search inside or outside the organization, you need to publicize the opening. If you are looking internally in a small organization, you can alert employees informally. In larger organizations, HR managers generally post openings on bulletin boards (often online) or announce them in newsletters. They can also seek direct recommendations from various supervisors.

Recruiting people from outside is more complicated. It is a lot like marketing a product to buyers: in effect, you are marketing the virtues of working for your company. Starbucks uses the following outlets to advertise openings:

- A dedicated section of the corporate website ("Job Centre," which lists openings, provides information about the Starbucks experience, and facilitates the submission of online applications).

- College and university campus recruiting (holding on-campus interviews and information sessions and taking part in career fairs).

- Internships designed to identify future talent among college students.

- Announcements on employment websites like:

  - [LinkedIn](#), [Workopolis](#), [Indeed](#), [LeapOut](#), [JobBank](#), [Eluta](#).

- Social Media.

- Local job fairs.

In-store recruiting posters.

Informative “business cards” for distribution to customers.<sup>121</sup>



SOURCE: [Alex Green](#).

When asked what it takes to attract the best people, Starbucks's senior executive Dave Olsen replied, “Everything matters.” Everything Starbucks does as a company bears on its ability to attract talent. Everyone recruits, not just HR specialists. In fact, the best source of quality applicants is often the company's own labour force.<sup>122</sup>

## The Selection Process

Recruiting gets people to apply for positions, but once you have received applications, you still must select the best candidate, another complicated process.

The selection process entails gathering information on candidates, evaluating their qualifications, and choosing the right one. At the very least, the process can be time-consuming

(particularly when you are filling a high-level position) and often involves several members of an organization.

Let us scrutinize the selection process by describing the steps you would take to work for the Canadian Security Intelligence Service.<sup>123</sup> Most business students rarely aspire to become CSIS agents, but CSIS is quite interested in business graduates, especially if you have a major in accounting or finance. With one of these backgrounds, you will be given priority in hiring. Why? Unfortunately, there is a lot of white-collar crime that needs to be investigated, and people who know how to follow the money are well suited for the task.



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## Contingent Workers

Though most people prefer to hold permanent, full-time positions, there is a growing number of individuals who work at temporary or part-time jobs, either by choice or as the only available option. Many of these are contingent workers hired to supplement a company's permanent workforce. Most of them are independent contractors, consultants, or freelancers who are paid by the firms that hire them. Others are on-call workers who work only when needed, such as substitute teachers. Still others are temporary workers (or "temps") who are employed and paid by outside agencies or contract firms that charge fees to client companies.

Video 1. Rise of the "Gig Economy"



*A YouTube element has been excluded from this version of the text. You can view it online here:*  
<https://pressbooks.library.upei.ca/startup/?p=569>

([Video Link](#))

## The Positives and Negatives of Temp Work

Using contingent workers provides companies with several benefits. Because they can be hired and fired easily, employers can better control labour costs. When things are busy, they can add temps, and when business is slow, they can release unneeded workers. Temps are often cheaper than permanent workers, particularly because they rarely receive costly benefits. Employers can also bring in people with specialized skills and talents to work on special projects without entering long-term employment relationships. Finally,

companies can “try out” temps: if someone does well, the company can offer permanent employment; if the fit is less than perfect, the employer can easily end the relationship. There are downsides to the use of contingent workers, including increased training costs and decreased loyalty to the company. Also, many employers believe that because temps are usually less committed to company goals than permanent workers, productivity suffers.

## **Developing Employees**

Because companies cannot survive unless employees do their jobs well, it makes economic sense to train them and develop their skills. This type of support begins when an individual enters the organization and continues if he or she stays there.

## **New Employee Orientation**

Have you ever started your first day at a new job feeling upbeat and optimistic only to walk out thinking that maybe you have taken the wrong job? If this happens too often, your employer may need to revise its approach to orientation, the way it introduces new employees to the organization and their jobs. Starting a new job is a little like beginning college; at the outset, you may experience any of the following feelings:

Somewhat nervous but enthusiastic.

Eager to impress but not wanting to attract too much attention.

Interested in learning but fearful of being overwhelmed with information.

Hoping to fit in and worried about looking new or inexperienced.<sup>124</sup>

The employer who understands how common such feelings are is more likely not only to help newcomers get over them but also to avoid the pitfalls often associated with new employee orientation:

Failing to have a workspace set up for you.

Ignoring you or failing to supervise you.

Neglecting to introduce you to coworkers.

Swamping you with facts about the company.<sup>125</sup>

A good employer will take things slowly, providing you with information about the company and your job on a need to know basis while making you feel as comfortable as possible. You will get to know the company's history, traditions, policies, and culture over time and learn more about salary, benefits, and how your performance will be evaluated. You will find out how your job fits into overall operations and what is expected of you.

## Training and Development

It would be nice if employees came with all the skills, they need to do their jobs. It would also be nice if job requirements stayed the same: once you have learned how to do a job, you would know how to do it forever. New employees must be trained; as they grow in their jobs or as their jobs change, they will need additional training. Unfortunately, training is costly and time-consuming. How costly? The Conference Board of Canada reported Canadian companies spent \$688 per employee for training in 2010.

Many Canadian companies focus much of their training on diversity skills. What is the payoff? They create a more inclusive workplace and bring fresh voices and ideas to their way of doing business. Some of these companies also get

additional rewards by being recognized as being [Canada's Best Diversity Employers](#).<sup>126</sup> At Booz Allen Hamilton, consultants specialize in finding innovative solutions to client problems, and their employer makes sure that they're up-to-date on all the new technologies by maintaining a "technology petting zoo" at its training headquarters. It is called a "petting zoo" because employees get to see, touch, and interact with new and emerging technologies. For example, a Washington Post reporter visiting the "petting zoo" in 2007 saw fabric that could instantly harden if struck by a knife or bullet, and "smart" clothing that could monitor a wearer's health or environment.<sup>127</sup>

At Booz Allen Hamilton's technology "petting zoo," employees are receiving off-the-job training. This approach allows them to focus on learning without the distractions that would occur in the office. More common, however, is informal on-the-job training, which may be supplemented with formal training programs. This is the method, for example, by which you'd move up from mere coffee maker to a full-fledged "barista" if you worked at Starbucks.<sup>128</sup> You'd begin by reading a large spiral book (titled Starbucks University) on the responsibilities of the barista, pass a series of tests on the reading, then get hands-on experience in making drinks, mastering one at a time.<sup>129</sup> Doing more complex jobs in business will probably require even more training than is required to be a barista.

## Equity, Inclusion, and Diversity in the Workplace

The makeup of the Canadian workforce has transformed over the past 50 years. In the 1950s, over 70% was composed of males.<sup>130</sup> Today's workforce reflects the broad

range of differences in the population (differences in gender, race, ethnicity, age, physical ability, religion, education, and lifestyle). As you can see below, more women have entered the workforce.<sup>131</sup>

Figure 2. Employment by GenderGroup, 2017

	FEMALES	MALES
Population	50.7%	49.3%
Workforce	47.4%	52.6%
Relative Participant Rate	0.93	1.06

Most companies today strive for diverse workforces. HR managers work hard to recruit, hire, develop, and keep a diverse workforce. In part, these efforts are motivated by legal concerns: discrimination in recruiting, hiring, advancement, and firing is illegal under federal law and is prosecuted by the Canadian Human Rights Tribunal.<sup>132</sup> Companies that violate anti-discrimination laws are subject to severe financial penalties and risk reputational damage.

Reasons for building a diverse workforce go well beyond mere compliance with legal standards. It even goes beyond commitment to ethical standards. It is good business. People with diverse backgrounds bring fresh points of view that can be invaluable in generating ideas and solving problems. In addition, they can be the key to connecting with an ethnically diverse customer base. In short, capitalizing on the benefits of a diverse workforce means that employers should view differences as assets rather than liabilities.

## What Makes a Great Place to Work?

Every year, [Great Place to Work Canada](#) analyzes



comments from thousands of employees and compiles a list of “The 100 Best Companies to Work for in Canada,” which is published in Fortune magazine. Having compiled its list for over 20 years, the institute concludes that the defining characteristic of a great company to work for is trust between managers and employees. Employees overwhelmingly say that they want to work at a place where employees “trust the people they work for, have pride in what they do, and enjoy the people they work with.”<sup>133</sup> They report the motivation to perform because they are challenged, respected, treated fairly, and appreciated. They take pride in what they do, are made to feel that they make a difference, and are given opportunities for advancement.<sup>134</sup> The most effective motivators, it would seem, are closely aligned with Maslow’s higher level needs and Herzberg’s motivating factors. The top ten companies are listed below.

## Job Redesign

Rank	Organization	
1	<a href="#">Google</a>	6 <a href="#">G</a>
2	<a href="#">Kruger Products</a>	7 <a href="#">G</a>
3	<a href="#">Hydro-Québec</a>	8 <a href="#">S</a>
4	<a href="#">SAP</a>	9 <a href="#">S</a>
5	<a href="#">Vitalité Health Network</a>	10 <a href="#">G</a>

The average employee spends over 2,000 hours a year at work. If the job is tedious, unpleasant, or otherwise unfulfilling, the employee probably will not be motivated to perform at a top-level. Many companies practice a policy of

job redesign to make jobs more interesting and challenging. Common strategies include job rotation, job enlargement, and job enrichment.



SOURCE: [Valeria Boltneva](#).

## Job Rotation

Specialization promotes efficiency because workers get very good at doing tasks. The drawback is the tedium of repeating the same task day in and day out. The practice of job rotation allows employees to rotate from one job to another systematically, often but not cycling back to their original tasks. A computer maker, for example, might rotate a technician into the sales department to increase the employee's awareness of customer needs and to give the employee a broader understanding of the company's goals and operations. A hotel might rotate an accounting clerk to the check-in desk for a few hours each day to add variety to the daily workload. Through job rotation, employees develop new skills and gain experience that increases their value to the company. So great

is the benefit of this practice that many companies have established rotational training programs that include scheduled rotations during the first 2 to 3 years of employment. Companies benefit because cross-trained employees can fill in for absentees, thus providing greater flexibility in scheduling, offer fresh ideas on work practices, and become promotion-ready more quickly.

## **Job Enlargement**

Instead of a job in which you performed just one or two tasks, wouldn't you prefer a job that gave you many tasks? In theory, you would be less bored and more highly motivated if you had a chance at job enlargement, the policy of enhancing a job by adding tasks at similar skill levels. The job of sales clerk, for example, might be expanded to include gift-wrapping and packaging items for shipment. The additional duties would add variety without entailing higher skill levels.

## **Job Enrichment**

Merely expanding a job by adding similar tasks will not necessarily “enrich” it by making it more challenging and rewarding. Job enrichment is the practice of adding tasks that increase both responsibility and opportunity for growth. It provides the kinds of benefits that, according to Maslow and Herzberg, contribute to job satisfaction: stimulating work, sense of personal achievement, self-esteem, recognition, and a chance to reach your potential.

Consider, for example, the developing role of support staff in the contemporary office. Today, employees who used to be called “secretaries” assume many duties previously in

the domain of management, such as project coordination and public relations. Information technology has enriched their jobs because they can now apply such skills as word processing, desktop publishing, creating spreadsheets, and managing databases. That is why we now use a term such as administrative assistant instead of secretary.<sup>135</sup>

## Life and Work Quality

Building a career requires a substantial commitment in time and energy, and often not left with much time for non-work activities. Fortunately, many organizations recognize the need to help employees balance their work and home lives.<sup>136</sup> By helping employees combine satisfying careers and fulfilling personal lives, companies tend to end up with a happier, less stressed, and more productive workforce. The financial benefits include lower absenteeism, turnover, and health care costs.



SOURCE: [Pixabay](#).

## Alternative Work Arrangements

The accounting firm KPMG LLP, which has consistently made the list of the “Canada’s Top Family-Friendly Employers,”<sup>137</sup> and is committed to help “employees balance work and their personal lives through a variety of flexible work options.”<sup>138</sup>

### Flextime

Employers who provide for flextime set guidelines that allow employees to designate starting and quitting times. Guidelines, for example, might specify that all employees must work eight hours a day (with an hour for lunch) and that four hours must be between 10 a.m. and 3 p.m. You could come in at 7 a.m. and leave at 4 p.m., while coworkers arrive at 10 a.m. and leave at 7 p.m. With permission you could even choose to work from 8 a.m. to 2 p.m., take two hours for lunch, and then work from 4 p.m. to 6 p.m.

### Compressed Workweeks

Rather than work eight hours a day for five days a week, you might elect to earn a three-day weekend by working ten hours a day for four days a week.

### Job Sharing

Under job sharing, two people share one full-time position, splitting the salary and benefits of the position as

each handle half the job. Often, they arrange their schedules to include at least an hour of shared time during which they can communicate about the job.

## Telecommuting

Telecommuting means that you regularly work from home (or from some other non-work location). You are connected to the office by computer and cell phone. You save on commuting time, enjoy more flexible work hours, and have more opportunity to spend time with your family. A study of 5,500 IBM employees (one-fifth of whom telecommute) found that those who worked at home not only had a better balance between work and home life but also were more highly motivated and less likely to leave the organization.<sup>139</sup>

Though it is hard to count telecommuters accurately, Statistics Canada estimates that, in 2008, 11% of employees work from home.<sup>140</sup> Telecommuting is not for everyone. Working at home means that you must discipline yourself to avoid distractions, such as TV, personal phone calls, and home chores and not be impacted by feeling isolated from the workplace social interaction.

## Family-Friendly Programs

Besides alternative work arrangements, many employers, including KPMG LLP and BASF Canada, offer programs, and benefits designed to help employees meet family and home obligations while maintaining busy careers. As exemplar companies, they offer the following benefits.<sup>141</sup>

## Dependent Care

Caring for dependents (young children and elderly parents) is of utmost importance to some employees but combining dependent care responsibilities with a busy job can be difficult. Through its Personal Care program, KPMG LLP provides employees with up to 50 hours of paid time off annually to help with a range of personal matters. They also offer emergency backup dependent care all year round, either at a provider's facility or in the employee's home. KPMG LLP also has a Working Parents Network, Special Parents Network, offering support for parents raising children with physical, emotional, and behavioural (virtual support group for parents raising children with physical, emotional, and behavioural issues. Meanwhile, BASF Canada offers its employees a privately run on-site childcare facility.

## Parental Leave and Support

New parents in Canada are guaranteed paid leave via Employment Insurance Maternity and Parental Benefits. BASF Canada tops-up these payments for new parents to 100% of salary for up to 17 weeks. KPMG LLP further supports new parents by providing those on leave support with their transition back to work.

## Caring for Yourself

Both KPMG LLP and BASF Canada offer employees comprehensive health and dental benefit coverage programs. They also provide employees with generous vacation allowances and personal days for employees to use in any way

they want. Both organizations also offer an Employee Assistance Program for employees experiencing personal and/or work-related problems that may negatively affect their job performance and overall wellbeing. If staying fit makes you happier and more productive, BASF Canada offers a \$400 fitness club subsidy and KPMG LLP offers the equivalent of 1.25% of an employee's salary for home gym equipment.<sup>142</sup>



SOURCE: [Kelly Lacy](#).

## Unmarried Without Children

You have undoubtedly noticed by now that many programs for balancing work and personal lives target married people, particularly those with children. Single individuals also have trouble striking a satisfactory balance between work and non-work activities, but many single workers feel they are not getting equal consideration from employers.<sup>143</sup> They report having to work longer hours, travel more, and take on hard assignments to compensate for married employees with family commitments.

Requiring singles to take on additional responsibilities can make it harder for them to balance their work and personal



lives. It is harder to plan and keep personal commitments while meeting heavy work responsibilities. Frustration can lead to increased stress and job dissatisfaction. In several studies of stress in the accounting profession, unmarried workers reported higher levels of stress than any other group, including married people with children.<sup>144</sup>

With singles, as with married people, companies can reap substantial benefits from programs that help employees balance their work and non-work lives. PepsiCo, for example, offers a “concierge service,” which maintains a dry cleaner, travel agency, convenience store, and fitness centre on the premises of its national office in Somers, New York.<sup>145</sup> Single employees seem to find these services helpful, but what they value most of all is control over their time. They want predictable schedules that allow them to plan social and personal activities. They do not want employers assuming that being single means they can change plans at the last minute. It is often more difficult for singles to deal with last minute changes because, unlike married coworkers, they don’t have the at home support structure to handle such tasks as tending to elderly parents or caring for pets.

## Compensation and Benefits

Though paychecks and benefits packages are not the only reasons people work, they do matter. Competitive pay and benefits also help organizations attract and keep qualified employees. Companies that pay their employees more than their competitors generally have lower turnover. Consider, for example, The Container Store, which regularly appears on Fortune magazine’s list of “The 100 Best Companies to Work For.”<sup>146</sup> The U.S. retail chain staffs its stores with fewer employees than its competitors but pays them more, sometimes, three times the industry average for retail workers.

This strategy allows the company to attract extremely talented workers who, are not likely to leave the company. Low turnover is valuable in the retail industry because it depends on service-oriented personnel to generate repeat business. Besides salary and wages, compensation packages often include other financial incentives, such as bonuses and profit-sharing plans, as well as benefits, such as medical insurance, vacation time, sick leave, and retirement accounts.

## **Wages and Salaries**

The largest, and most important, component of a compensation package is the payment of wages or salary. If you are paid according to the number of hours you work, you are earning wages. Counter personnel at McDonald's, for instance, get wages, which are determined by multiplying an employee's hourly wage rate by the number of hours worked during the pay period. If you are paid for fulfilling the responsibilities of a position (regardless of the number of hours required to do it) you are earning a salary. The McDonald's manager gets a salary for overseeing the operations of the restaurant. He or she is expected to work if it takes to get the job done, with no change in compensation.

## **Piecework and Commissions**

Sometimes it makes more sense to pay workers according to the quantity of product that they produce or sell. North Nova Seafoods Ltd., a seafood processing plant in Pictou, Nova Scotia, pays workers on piecework: workers' pay is based on the number of fish they have cut, cleaned, and trimmed, or the number of lobsters they have disjointed and picked meat

from. If you are working on commission, you are probably getting paid a percentage of the total dollar amount you sell. If you were a sales representative for an insurance company, like The Co-operators, you would get a certain amount of money for each automobile or homeowner policy you sold.

## Incentive Programs

Besides regular paychecks, many people receive financial rewards based on performance, whether their own, their employer's, or both. Other incentive programs designed to reward employees for excellent performance include bonus plans and stock options.

### Bonus Plans

Cisco Systems Canada's year-end bonuses (annual income given besides salary) are based on individual and company-wide performance. If the company has a profitable year, and if you contributed to that success, you will get a bonus. They refer to it as "rewarding people for their performance, not their seniority".<sup>147</sup>

Bonus plans have become quite common, and the range of employees eligible for bonuses has widened in recent years. In the past, bonus plans were usually reserved for managers above a certain level. Today, companies have realized the value of extending plans to include employees at virtually every level. The magnitude of bonuses still favours those at the top.

## Profit-Sharing Plans

[Nature's Path Foods](#) and [Canadian Tire](#) both have profit-sharing arrangements with employees. Today, many Canadian companies offer some type of profit-sharing program.<sup>148</sup> Canadian Tire's plan has long been part of its operating principles, having been around since the late 1960s. Here is how it works. An employee's profit share is paid annually as a percentage of the employee's earnings and is based on the company's net profit. Profits in the most recent years have averaged to be about 10%. Interestingly, because this profit share is part of an employee's retirement savings, it is put into a deferred profit-sharing account.<sup>149</sup>

## Stock Option Plans

WestJet's compensation plan also gives employees the right to take part in their Employee Share Purchase Plan. This enables employees to purchase WestJet shares amounting to up to 20% of their gross salary and the company will match their contributions. This incentive attracts and keeps good people.

U.S.-based Starbucks is not nearly as selective in awarding stock options. At Starbucks, all employees can earn "Bean Stock," the Starbucks employee stock option plan. Both full- and part-time employees get Starbucks shares based on their earnings and their time with the company. If the company does well and its stock goes up, employees make a profit. CEO Howard Schultz believes that Bean Stock pays off because employees are rewarded when the company does well, they have a stronger incentive to add value to the company (and so drive up its stock price). Starbucks has a video

explaining their employee stock option program on this [webpage](#).<sup>150</sup>

## Benefits

Another major component of an employee's compensation package is benefits (compensation other than salaries, hourly wages, or financial incentives). Types of benefits include:

- Legally required benefits (Employment Insurance, Canada Pension Plan, Workplace Safety and Insurance Boards).

- Paid time off (vacations, holidays, sick leave).

- Insurance (health benefits, life insurance, disability insurance).

- Retirement benefits.

The cost of providing benefits is staggering. According to a 2015 survey by the Conference Board of Canada, it costs employers an average of \$8,330 to provide benefits for each full-time employee. More than half of the employers surveyed showed a rise in benefit costs, with an average 6.2% increase between 2013 and 2014.<sup>151</sup>

Many workers received benefits besides those required by law, including vision care, semi-private hospital stays and out-of-country medical coverage.<sup>152</sup> Plus many companies surveyed showed that they provided benefits to permanent part-time employees who work a minimum number of hours per week. Part-timers often receive no benefits at all.<sup>153</sup>

## Performance Appraisal

Employees generally want their managers to tell them three things: what they should do, how well they are doing it,

and how they can improve their performance. Good managers address these issues actively. On a semi-annual or annual basis, they also conduct formal performance appraisals to discuss and evaluate employees' work performance.

## The Basic Three-Step Process

Appraisal systems vary both by organization and by the level of the employee being evaluated, but as you can see in the Figure below, it is generally a three-step process:

Before managers can measure performance, they must set goals and performance expectations and specify the criteria (such as quality of work, quantity of work, dependability, initiative) that they will use to measure performance.

At the end of a specified period, managers complete written evaluations that rate employee performance according to the predetermined criteria.

Managers then meet with each employee to discuss the evaluation. Jointly, they suggest ways in which the employee can improve performance, which might include further training and development.

Figure 3. The Performance Appraisal Process

01

Set goals and performance expectations and specify the criteria that will be used to measure performance.

02

Complete a written evaluation that rates performance according to the stipulated criteria.

03

Meet with the employee to discuss the evaluation and suggest means of improving performance.

It sounds simple, but why do so many managers report that, except for firing people, giving performance appraisals is their least favourite task?<sup>154</sup> To get some perspective on this question, we will look at performance appraisals from both sides, explaining the benefits and identifying potential problems with some of the most common practices.

Among other benefits, formal appraisals provide:

An opportunity for managers and employees to discuss an employee's performance and to set future goals and performance expectations.

A chance to identify and discuss training and career-development opportunities for an employee.

Formal documentation of the evaluation that can be used for salary, promotion, demotion, or dismissal purposes.<sup>155</sup>

As for disadvantages, most stem from the fact that appraisals are often used to determine salaries for the upcoming year. Meetings to discuss performance tend to take on an entirely different dimension: the manager may appear judgemental (rather than supportive), and the employee may

get defensive. This adversarial atmosphere can make many managers not only uncomfortable with the task but also less likely to give honest feedback (They may give higher marks to avoid delving into critical evaluations). HR professionals disagree about whether performance appraisals should be linked to pay increases. Some experts argue that the connection eliminates the manager's opportunity to use the appraisal to improve an employee's performance. Others maintain it increases employee satisfaction with the process and distributes raises based on effort and results.<sup>156</sup>

## 360-Degree and Upward Feedback

Instead of being evaluated by one person, how would you like to be evaluated by several people, not only those above you in the organization but those below and beside you? The approach is called 360-degree feedback, and the purpose is to ensure that employees (mostly managers) get feedback from all directions, from supervisors, reporting subordinates, coworkers, and even customers. If it is conducted correctly, this technique furnishes managers with a range of insights into their performance in several roles.

Some experts, however, regard the 360-degree approach as too cumbersome. An alternative technique, called upward feedback, requires only the manager's subordinates to provide feedback. Computer maker Dell uses this approach as part of its manager-development plan. Every year, 40,000 Dell employees complete a survey in which they rate their supervisors on several dimensions, such as practising ethical business principles and providing support in balancing work and personal life. Dell uses survey results for development only, not as direct input into decisions on pay increases or promotions.<sup>157</sup>



## Keeping Valuable Employees

When a valued employee quits, the loss to the employer can be serious. Not only will the firm incur substantial costs to recruit and train a replacement, but it also may suffer temporary declines in productivity and lower morale among remaining employees who must take on heavier workloads. Given the negative impact of turnover (the permanent separation of an employee from a company) most organizations do whatever they can to keep qualified employees. Compensation plays a key role in this effort: companies that do not offer competitive compensation packages tend to lose employees. Other factors also come into play, such as training and development, as well as helping employees achieve a satisfying work/non-work balance. In the following sections, we will look at a few other strategies for reducing turnover and increasing productivity.<sup>158</sup>

## Creating a Positive Work Environment

Employees who are happy at work are more productive, provide better customer service, and are more likely to stay with the company. Vancouver-based Telus Corp., tracks their employee engagement with the help of a human resource consulting firm, with a 31% increase from 2007 to 2014. This increase was shown to impact higher customer satisfaction, besides low turnover rates, an increase in job applications and an increase in their stock price.

Watch the video below from Daniel Pink, which summarizes recent research on motivation and comes to some interesting conclusions.<sup>159</sup>

Video 2. RSA Shorts “Drive” Video



A YouTube element has been excluded from this version of the text. You can view it online here:

<https://pressbooks.library.upei.ca/startup/?p=569>

([Video Link](#))

## The Employee-Friendly Workplace

What sort of things improve employee attitudes? The 12,000 employees of software maker SAS Institute fall into the category of “happy workers.” They choose the furniture and equipment in their offices, eat subsidized meals at one of three on-site restaurants, and enjoy other amenities like a 77,000 square-foot fitness centre. They also have job security: no one’s ever been laid off because of an economic downturn. The employee-friendly work environment helps SAS employees

focus on their jobs and contribute to the attainment of company goals.<sup>160</sup> It also results in very low 3% turnover.

## Recognizing Employee Contributions

Thanking people for work done well is a powerful motivator. People who feel appreciated are more likely to stay with a company than those who do not.<sup>161</sup> While a personal thank you is always helpful; many companies also have formal programs for identifying and rewarding excellent performers. The U.S.-based Container Store rewards employed accomplishments in a variety of ways. For example, employees with 20 years of service are given a “dream trip” where one employee went on a seven-day Hawaiian cruise.<sup>162</sup> The company is known for its supportive environment and in 2016 celebrated its 17<sup>th</sup> year on Fortune’s 100 Best Companies to Work For®.<sup>163</sup>

## Involving Employees in Decision Making

Companies have found that involving employees in decisions saves money, makes workers feel better about their jobs, and reduces turnover. Some have found that it pays to take their advice. When General Motors asked workers for ideas on improving manufacturing operations, management was deluged with over 44,000 suggestions during one quarter. Implementing a few of them cut production time on certain vehicles by 15% and resulted in sizable savings.<sup>164</sup>

Similarly, in 2001, Edward Jones, a personal investment company, faced a difficult situation during the stock market downturn. Costs had to be cut and laying off employees was one option. Instead, however, the company turned to its

workforce for solutions. As a group, employees identified cost savings of more than \$38 million. The company convinced experienced employees to stay with it by assuring them they would have a role in managing it.<sup>165</sup>

## Why People Quit

As important initiatives can be, one terrible boss can spoil everything. The way a person is treated by his or her boss may be the primary factor in determining whether an employee stays or goes. People who have quit their jobs cite the following behaviour by superiors:

- Making unreasonable work demands.

- Refusing to value their opinions.

- Failing to be clear about what is expected of subordinates.

- Showing favouritism in compensation, rewards, or promotions.<sup>166</sup>

Holding managers accountable for excessive turnover can help ease the “bad-boss” problem, at least in the long run. Whenever an employee quits, it is a good idea for someone (other than the individual’s immediate supervisor) to conduct an exit interview to find out why. Knowing why people are quitting gives an organization the opportunity to correct problems that are causing high turnover rates.

## Involuntary Termination

Before we leave this section, we should say a word or two about termination, getting fired. Though turnover (voluntary separations) can create problems for employers, they are not nearly as devastating as the effects of involuntary termination on employees. Losing your job is what

psychologists call a “significant life change,” and it’s high on the list of “stressful life events” regardless of the circumstances. Sometimes, employers lay off workers because revenues are down, and they must resort to downsizing, to cutting costs by eliminating jobs. Sometimes a particular job is being phased out, and sometimes an employee has simply failed to meet performance requirements.

## **Employment At-Will (U.S. *not* Canada)**

Is it possible for you to get fired even if you are doing a good job and there is no economic justification for your being laid off? Sometimes, yes, especially if you are not working under a contract. Without a formal contract, you are employed at-will, so both you and your employer may terminate the employment relationship. You can quit whenever you want, but your employer can also fire you whenever they want.

Fortunately for employees, over the past several decades, the courts have made several decisions that created exceptions to the employment at-will doctrine.<sup>167</sup> Since managers generally prefer to avoid the expense of fighting wrongful discharge claims in court, many no longer fire employees at-will. A good practice in managing terminations is to maintain written documentation so that employers can show just cause when ending an employee. If it is a case of poor performance, the employee would be warned that his or her current level of performance could cause termination and then be permitted an opportunity to improve performance. When termination is necessary, communication should be handled in a private conversation, with the manager explaining precisely why the action is being taken.

## *Key Takeaways*

The process of human resource management comprises actions that an organization takes to attract, develop, and keep quality employees.

Human resource managers engage in strategic human resource planning by developing a plan for satisfying the organization's human resource needs.

The HR manager forecasts future hiring needs and begins the recruiting process to fill those needs.

In recruiting and hiring, managers must comply with anti-discrimination laws enforced by the Equal Employment Opportunity Commission (EEOC). They cannot treat people unfairly because of a characteristic unrelated to ability, such as race, colour, religion, sex, national origin, age, or disability.

HR managers also oversee employee training, from the first orientation to continuing on, or, off-the-job training.

Attracting a diverse workforce goes beyond legal compliance and ethical commitments, because a diverse group of employees can offer perspectives that may be valuable in generating ideas, solving problems, and connecting with an ethnically diverse customer base.

Employees are motivated to perform well when they're challenged, respected, treated fairly, and appreciated.

Some other factors that contribute to employee satisfaction include job redesign to make jobs more interesting and challenging, job rotation, which allows employees to rotate from one job to another, job enlargement, which enhances a job by adding tasks at similar skill levels, and job enrichment, which adds tasks that increase both responsibility and opportunity for growth.

Many organizations recognize the need to help employees balance their work and home lives and offer a variety of work arrangements to accommodate different employee needs, such as flextime (flexible scheduling), job sharing (when two people share a job), and telecommuting (working from outside the office).

Compensation includes pay and benefits. Workers who are paid by the hour earn wages, while those who are paid to fulfill the responsibilities of the job earn salaries. Some people receive commissions based on sales or are paid for output, based on a piecework approach.

In addition, employees may receive year-end bonuses, take part in profit-sharing plans, or receive stock options.

Managers conduct performance appraisals to evaluate work performance.

Turnover is the permanent separation of an employee from a company and may happen if an employee is unsatisfied with their job, or because the organization is not satisfied with the employee. Sometimes, firms lay off workers, or downsize, to cut costs.

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# 12/ Social Resources

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SOURCE: [TheAndrasBarta](#).

## Building Networks and Foundations

### *Learning Objectives*

Define networking and describe its role in entrepreneurship.

Describe networking opportunities.

Describe local and trade organization networking opportunities.

Identify non-profit and governmental agencies offering networking opportunities.

U.S. Route 1 in southern Florida connects 43 islands of the Florida Keys via 42 bridges. It is a bidirectional economic path from the U.S. mainland to its endpoint at Key West and for all points in between. Without the bridges it provides, residents, workers, and tourists would be required to ferry to their destinations, sacrificing time, money, economic efficiency, market productivity, and recreation. The bridges ensure an unimpeded flow of economic activities that benefit residents and visitors, increasing tourism across the entire state, and ensuring Key West is not economically and socially isolated.

Every entrepreneur can learn a few lessons from U.S.

1. First, independent market players are stronger and more stable when connected to other independent market players. Second, connections are not always easy to establish. The idea of connecting all the keys met resistance, and engineers had to solve many challenges. Third, you must be prepared to repair connections whenever they are severed. A hurricane destroyed the original railroad that connected the islands but replacing it with an automobile highway was a major improvement. Other lessons are that benefits should outweigh costs, and that it takes time to build new connections: The original railroad took seven years to build. Costs of ongoing repair and maintenance have exceeded \$1.8 billion<sup>168</sup> (adjusted for inflation) but produced \$2.7 billion in annual economic activity for

2017.<sup>169</sup> Today, no one in Florida would dream of doing without the highway.



SOURCE: [Dwsquire](#).

How are businesses like Key West? Every business includes people who produce goods and services for customers to purchase. Businesses and those who work for them need to consume the products and services provided by their own vendors. Finding and establishing relationships with vendors and customers, besides the support of community organizations and educational resources, facilitates the exchange of information, products, and services. The connection between a business and its vendors or its customers makes up a network.

When you think about your new and exciting entrepreneurial venture, you may feel somewhat like the citizens of Key West did many years ago, isolated. No matter which way you turn, you eventually come to the end of your limited community, and what you have is not enough. You can either sit on the beach and dream about what could be or begin working on building personal and professional



connections to broaden your scope and improve the depth of relationships with those individuals who will assist you in becoming a successful entrepreneur. Now is the time to build bridges and connecting yourself with the greater business community. Networking is about building bridges not about collecting tolls.

For an entrepreneur, **networking** is finding and establishing relationships with business professionals with whom you can exchange information, ideas, and products; you can claim these networks as trusted business colleagues. Be ready to use the networks you already have. Be intentional in seeking established business professionals in your local chamber of commerce or at SCORE (see the following). Position yourself to contribute to the larger community. Be active in expanding your sphere of influence.

A good way to get started is to brainstorm a list of people who can help you along the entrepreneurial path. These potential trusted advisors will be beneficial to you as you develop your idea and start your business. In these early stages, you will encounter challenges and obstacles in many areas. Having a “go-to” list of dependable consultants can help you find solutions, reduce mistakes, and hasten your success in your new business. Anyone can be on that list, do not exclude anyone, no matter how unlikely you will need their expertise. People you already know have knowledge and skills. They can be a valuable resource.

You too have knowledge and skills. You too can be a valuable resource. That is why you are starting your own business or developing a new product. Begin connecting with people who need you, perhaps even people who need you more than you currently need them. Present yourself as the expert, not the salesperson to be avoided at all costs. Become known as the “go-to” person: the person others will seek and put on their list of experts. When you become respected as the professional expert, success will follow.

We develop personal connections, relationships with other people, early in our lives. (Later in life, these connections become our networks.) Typically, the first social groups we join are family, neighbours, and schoolmates. Playing with siblings and cousins and learning to meet new friends in the neighbourhood and at elementary school help us develop the social skills that we will need later in life when we meet and work with others in the professional world. As you enter adulthood, social connections that you establish and nurture become more complex and have longer-lasting benefits. You may establish some of those lifelong personal connections during your college years, or perhaps in your first “big” job.

## **Campus Connections**

During your college years, you will have many opportunities to make connections with new people. Taking advantage of these opportunities allows you to perfect your skills in initiating and developing new and even lifetime connections. You can establish new friendships with roommates, classmates, social club members, special interest groups, academic organizations, competitive and intramural athletic teams, and many others. All these groups not only encourage new social relationships but also foster opportunities for developing and improving leadership skills.

Your college or university is usually where you transition from student to professional. One method of learning to become a professional is through membership and leadership roles in academic or professional clubs. Leadership positions usually rotate annually. Academic clubs are formed around disciplines, departments, or professions. Professors, alumni, or industry professionals serve as sponsors and may provide connections to other industry professionals. Members learn the value of being active participants, discussing relevant

topics. Fundraising or other special activities provide opportunities for developing leadership and organizational skills. Friendships and personal connections made in an academic club may become lifelong professional connections.

Honour societies are another type of academically oriented group, established to recognize the outstanding academic performance of students who have achieved a specific grade point average. Membership in an honour society brings with it the prestige of membership, opportunities for leadership roles, and access to professionals in many industries. Some honour societies offer scholarships for future studies in graduate school or study abroad programs, which introduce members to students from other universities and countries with similar backgrounds and interests. Some honour societies open doors to conference memberships and presentations, and important access to other industry professionals.

Chances to meet and work with new people on college campuses are abundant. The diagram in the Figure below shows some of the many social networking opportunities on college campuses.

Figure 1. Social Networks on Campus



You can find many social networking opportunities through your college or university. (attribution: Copyright Rice University, OpenStax, under CC BY 4.0 license)

Another type of collegiate organization is the special interest group. These groups may focus on social causes, promote, and advance interests in the arts or other hobbies, or encourage participation in political, religious, or athletic events. Students from all disciplines and social backgrounds join special interest clubs. With such a broad spectrum of members, you can learn from many people from multiple backgrounds, expand your self-development, learn how to work with people who have different viewpoints, and potentially establish firm personal relationships.

Some clubs offer members the opportunity to perform or showcase their talent in a more relaxed and supportive

atmosphere or are centred on a personal interest. For example, a drama club for students not majoring in theater can offer a forum for participating in musicals and plays without the rigour demanded by the more structured academic program. Other groups that bring in non-academic members include choral groups, visual arts gatherings, astronomy clubs, and gaming societies. These groups provide opportunities for the maturation and perfection of the interpersonal skills you need for success in the professional world. You can develop key interpersonal attributes among friends and colleagues while enjoying a common activity or interest.



SOURCE: [Afta](#).

Social clubs (sororities for women and fraternities for men) provide other opportunities to expand your circle of friends, as these organizations focus on social activities. Although many social clubs concentrate strictly on “get-together” activities, you can learn and perfect acceptable public-protocol behaviours at formal events and mastering skills in organizational negotiations and compromise. A few colleges and universities are formalizing clubs for online students, including access to and membership in campus-

based Greek life. One of the first online Greek clubs is Theta Omega Gamma, founded in 2009 at the Florida Institute of Technology.

College groups have high turnover rates in their membership and involvement. This can make it easier for you to learn and perfect the skills necessary for establishing social and professional connections through constant repetition of introducing yourself to new people, learning their backgrounds, and describing your own. Learning how to introduce yourself and become acquainted with strangers is a soft skill that you can learn more easily early in life than in later years and knowing how to develop a personal relationship with others will benefit you for many years to come. One unintended benefit is that mistakes can be quickly forgotten. If you make a social blunder one semester, many in the group will soon forget your faux pas, and new members will never know it.



SOURCE: [Pixabay](#).

Perhaps the largest university club is one whose membership extends beyond graduation, the alumni association. Membership in alumni associations is higher

among students who earned an undergraduate degree than among those with a graduate degree. Members of the alumni association are more dedicated and loyal to their alma mater than non-members. Because of their commitment to past and current students, members of alumni associations have an automatic connection to other members. Loyalty is an important characteristic of active members of the alumni association, so bonding with them links you to established professionals who can help you in your new business. One way to connect with alumni is through LinkedIn, a social network of business professionals.

The campus setting (either traditional or virtual) is one of the earliest multifaceted environments to which you as a young adult will belong. Learning how to maneuver on the college campus and within the parameters of university culture prepares you for your future environment.

Non-traditional and virtual students also can benefit from their college campus experience. These students come from a variety of industry and professional backgrounds, and they are exposed to diverse operational methods and strategies during class activities or assignments. Becoming acquainted with project team members opens opportunities for building connections that might be professionally beneficial in the future.

Institutions of higher learning have become self-contained communities. Each one functions almost like a small city, with students mingling throughout the day with people at all stages of life, from multiple backgrounds, and in various roles. It is a great place to build a foundation of personal contacts or enhancing your current portfolio of contacts before entering a competitive world.

## What I Need and Who I Know?

Create a table with two columns. On the left, list questions associated with starting a new business, such as *How much money do I need to start? What licenses should I get? Do I lease or buy? Where do I find customers? Where do I find employees? How does payroll work? What kind of insurance should I get?*

On the right side, write specific answers that you already know. For questions and issues that you cannot answer, write the name of a person you could ask to help answer that issue. If you do not know someone, who might help you get to the person who can give you an answer?

## Local Organizations

Every community includes groups of individuals who have something in common. People group themselves together around shared beliefs, objectives, responsibilities, goals, or situations. Joining a local organization can place thousands of potential connections within your reach. Before seeking acceptance into a specific group, consider the type of group that fits your own personal and professional goals, and what you can contribute to the group's continuity.

An **open group** has a fluid membership; people may freely join or separate. Open groups are informal, operate around a loose structure, and frequently focus on a personal or social cause. Open-membership groups include activities-oriented groups such as bridge clubs, scrapbooking groups, or photography clubs. Some open groups, such as Mothers Against Drunk Drivers (MADD) or People for the Ethical Treatment of Animals (PETA), focus on a specific topic or cause.

A **closed group** typically has either formal or informal



criteria that you must meet before you can become a full member. Some organizations require sponsorship by a current member. Examples of closed groups include religious organizations, homeowners' or renters' associations, community performing arts groups, or sports groups.

Some community groups have features common to both open-and-closed groups. These **hybrid groups** have barriers or criteria that you must meet prior to joining, but those barriers are low, and prospective members can easily meet the criteria. Frequently, low barriers are an administrative feature to distinguish between participants who are serious about the group's activities and those who have an impulsive interest with no long-term commitment to the cause. The Table below shows the differences among open, closed, and hybrid groups.

Groups that have a formal legal structure, an oversight board, and a professional management staff are more effective than those groups that are impulsively formed around a good idea. Professionally organized groups have skilled employees who set long-term goals and handle day-to-day activities. With the increase in structure and management, costs increase. To cover employee wages and benefits along with operational expenses of the group, many professional groups have membership dues and revenue-generating activities that members are expected to take part in. Some professional groups are self-supporting, whereas others are joint efforts among local and regional governments, universities, and the private sector.

Table 1. Open, Closed, and Hybrid Groups

Open Groups	Closed Groups	Hybrid Groups
Fluid membership Loosely structured, informal May focus on personal/social cause	Membership criteria/process Structured Formal purpose	Low barriers to membership Maintain barriers to ensure members are serious

One of the most successful private-public partnerships is the chamber of commerce arrangement. Local business entities establish a chamber of commerce organization to enhance the local community while expanding their own businesses. Sometimes, the local government provides some type of monetary support for the chamber, but the chamber is neither an agency nor a function of government. For major community events, business members of a local chamber of commerce may provide their employees as volunteer staff who use their professional skills to organize and plan the event's activities. The community benefits, because a professionally managed event is held with minimal labour costs. The company receives publicity and exposure to potential customers within the local community at nominal costs. A close working partnership between the local chamber of commerce and government can produce outcomes that are mutually beneficial to local businesses and community citizens.

**Trade associations** are formed within specific industries and concentrate their efforts on issues and topics particular to one trade, profession, or philosophy. Functional trade associations include auto mechanics (Automotive Maintenance Repair Association, [amra.org](http://amra.org)), architects (the Association of Licensed Architects,

<https://www.alatoday.org/>), and marketing professionals (American Association of Advertising Agencies, [aaaa.org](http://aaaa.org)). Education groups, such as the Association of American Educators, focus on defining competencies and qualifications for teachers and publicly advocating for standards and regulations that affect teachers. Specialized groups also form associations, such as the National Association for the Education of Young Children.

Entrepreneurs who are looking for a franchise opportunity might consider an association that caters to franchisees, such as the International Franchise Association ([franchise.org](http://franchise.org)) or the American Association of Franchisees and Dealers ([aafd.org](http://aafd.org)). Companies interested in “going green” can join the [Green Business Network](#) at Green America. The [American Retirement Association](#) or [AARP](#) (formerly the American Association of Retired Persons, target retired individuals. Whatever the profession or industry, a trade association is certain to emerge to provide standards, training, support, and services to industry professionals and to be the industry’s collective voice to legislatures and government officials in establishing regulations, laws, and licensure qualifications.

Businesses need a steady supply of new customers to replace former customers who no longer have an active relationship with them. The primary purpose of *networking groups* is to help entrepreneurs gain new customers. These groups come in all kinds and sizes. [Business Network International](#) (BNI) provides qualified referrals to members. BNI limits its membership to only one person per industry or profession. Members are expected to exchange contact information regarding a qualified potential customer.

[Meetup](#) is a platform where people can meet others with similar wants and interests in an electronic or face-to-face engagement. Meetup’s groups are social or professional, business or entertainment, or relational or transactional.

Anyone can start a Meetup group if one does not already exist for their needs or interests. Each group's founders or members make the rules.

Whether a new entrepreneur needs a lot of support and guidance during the early stages of firm development, or a mature organization needs new potential customers, local organizations can provide an avenue to close connections and professionals who are committed to the local community and its businesses and people. As with all decisions, you must assess each opportunity in terms of the cost of membership and involvement in relation to the benefits you will receive.



SOURCE: [Pixabay](https://www.pixabay.com/).

## Business Incubators

**Business incubators** are normally associations established by a consortium of local organizations such as a chamber of commerce, local banks and other traditional businesses, and universities to provide complementary support to startup businesses and those in the early stages

of development. Services provided may include office space for rent at nominal charges; simple business expertise in accounting, legal matters, and marketing; and management support. Some incubators function as independent organizations, each with its own board of directors, whereas others may be stand-alone units of a university program. One of the best by products of being associated with business incubators is the communal contact with all the members' connections.

**Business accelerator's** function much like business incubators. A key difference between incubators and accelerators is equity investment. Business accelerators usually make some type of equity investment in their members' companies. Because the financial commitment raises the stakes for accelerators, these organizations carefully screen their prospects and select only those businesses that have a reasonable chance of financial success. An entrepreneur who joins an accelerator can expect to receive a lot of support for a commitment to the organization and a share of the profits. The Table below shows the differences between incubators and accelerators.

Table 2. Business Incubators and Accelerators

Functional Item	Incubators	Accelerators
Duration	One to five years	Three to six months
Cohorts	No	Yes
Business model	Rent; non-profit	Investment; can also be non-profit
Selection	Non-competitive	Competitive, cyclical
Venture stage	Early or late	Early
Education	Ad hoc, human resources, legal	Seminars
Mentorship	Minimal, tactical	Intense, by self and others
Venture locations	On-site	On-site

## Service Corps of Retired Executives (SCORE)

The Service Corps of Retired Executives (SCORE) is a non-profit organization based in Herndon, Virginia. SCORE partners with the federal Small Business Administration (SBA) and with retired executives from private businesses to offer education, training, and mentoring to small business owners. According to the SCORE website, it is the largest

network of volunteer and expert business mentors, with around 350 chapters. Small business owners can attend a workshop or view training videos available on the website. Templates of financial statements and business and marketing plans are also available on the website. Perhaps the most valuable service SCORE offers is a one-to-one mentoring program that can align a mentor with the specific skills that the business owner needs the most.

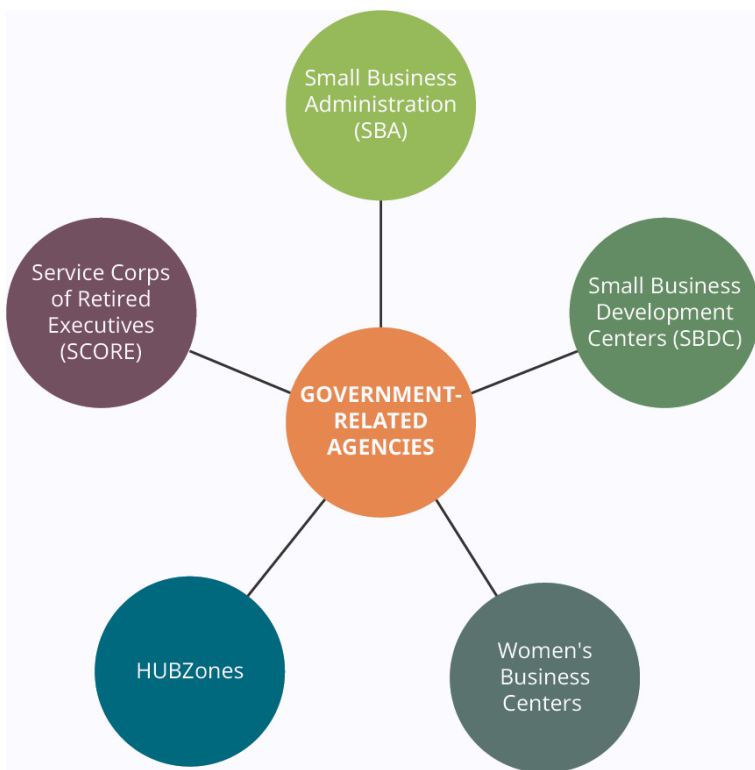
## Link to Learning



The [SCORE website includes a wealth of online resources on starting a business](#) such as online courses and regional workshops. You can also fill out a form to [request a mentor](#) to help you start your entrepreneurial journey.

## Government Agencies

Figure 2. Government Agencies Offering Assistance



Several government agencies exist to support entrepreneurs and small business owners. (attribution: Copyright Rice University, OpenStax, under CC BY 4.0 license)

Economic stability over the long-term depends on a continual supply of new companies and organizations. A business entity will close when the owner ceases operations or achieves the goals of starting the business. Sometimes a business cannot sustain operations or is forced into closure by regulatory agencies or licensing requirements. Regardless of why businesses close, new businesses must continually arise to replace them and grow the economy. Governments at the federal, state, county, and municipal levels have established agencies and programs to encourage new business development, support new businesses in the early years of



operations, and help young businesses mature to the point of self-sustainment. These include the SBA, Small Business Development Centres, Women's Business Centres, and HUBZones. The Figure above illustrates some of the government agencies that assist small businesses.

## **Small Business Administration**

One of the most popular agencies that helps businesses in the startup and early operations stages is the SBA. The SBA was established as an agency of the U.S. federal government in 1953. In 2012, the SBA merged with the divisions of the Department of Commerce, the Office of the U.S. Trade Representative, the Export-Import Bank, the Overseas Private Investment Corporation, and the U.S. Trade and Development Agency. The leadership of the SBA became a cabinet-level position.

The purpose of the SBA at the macro level is to assist and safeguard small businesses, protect and defend a competitive environment, and fortify the national economy. At the micro level, the SBA helps individuals "start, build, and grow" their businesses and companies through direct counselling, educational seminars and webinars, and public-private partnerships with institutions of higher education and foundations with similar goals and objectives.

Some of the most important activities of the SBA revolve around finances for small businesses. The SBA provides education in finance and money management, and guarantees loans through private lenders for capital, inventory, and startup costs. A business must meet the SBA's qualifications for funding, but the application and approval of the loan is handled at the local level by officers of a local bank or other SBA-approved financial vendor.



Are you looking for a lender to help you start your own business venture? The [Small Business Administration's Lender Match page](#) helps you.

Once a business is established and operating, ongoing activities are necessary to generate the cash flow to sustain the business. The SBA supports the ongoing operations of small businesses by being the liaison between small businesses and the federal government on bids and contracts. For fiscal year 2017, the federal government purchased \$105 billion<sup>170</sup> in products from small businesses.<sup>171</sup> However, becoming a vendor to the U.S. government is not like selling to a private business or the public. Free education and training materials are available from the SBA to introduce new businesses to the products that the government buys, the government's purchasing process for products and services, and the technical terms the government uses.

The SBA helps small businesses to maneuver through government purchasing processes through education, training, and support. The SBA has programs and funding operations that help economically disadvantaged individuals. These programs are self-contained within the SBA. Public-private partnerships or partnerships with universities or with other non-profit organizations are also possible.

## Small Business Development Centres (SBDC)

Over 1,000 SBDCs are funded through state grants with matching funds from the SBA.<sup>172</sup> Most SBDCs are on the campuses of local colleges or universities. Others are in entrepreneurial hubs or relate to business incubator programs.<sup>173</sup> The coordinator of a local SBDC may be an employee of either the university or the organization that

provides the office space. SBDC coordinators advise and information to small business owners at no charge because their fees and salaries are covered by the grants. The coordinators provide information, steer business owners to other sources of information, and provide a context for making operational or strategic decisions.

## **Office of Women's Business Ownership**

The Women's Business Centre (WBC) is a program funded in part or in whole by the SBA to focus specifically on helping women start and operate their own businesses.<sup>174</sup> Women business owners face the same challenges that men encounter, but women normally must add the role of business owner to their list of other personal responsibilities. Also, women have more limitations in access to capital and other financial resources than men typically experience. The WBC can provide support and access to resources that are unique to women. The WBC is operated through independent and educational centres in most states.

## **Veteran's Business Outreach Centre (VBOC)**

The SBA operates 20 VBOCs that focus on helping veterans and their families start and operate a new business.<sup>175</sup> A popular program of the VBOC is the Boots to Business program, which assists veterans transitioning from the military to the owner-operator role. Another program dedicated to veterans is the Service-Disabled Veteran-Owned (SDVO) Small Business Concern (SBC) program, administered through the Office of Small and Disadvantaged Business

Utilization. To qualify for the SDVO SBC program, the disabled veteran must directly own and control, at minimum, 51% of the business and have input into the day-to-day operations and a long-term strategy. Requirements vary according to the legal structure that is chosen. Title 13, Section 125 of the electronic Code of Federal Regulations lists other requirements and restrictions to be recognized as an SDVO SBC.<sup>176</sup>

## HUBZone

A HUBZone is a geographic location that has historically experienced low employment.<sup>177</sup> Many are also low-income areas because of limited transportation or educational opportunities. Through the HUBZone program, the SBA certifies and supports HUBZone businesses in acquiring government contracts and buying opportunities. Businesses that qualify may receive preferences in pricing. Qualifications for HUBZone designation are explained on the SBA/Government Contracting webpage. As of 2018, the federal government's goal is to award 3% of all federal contracting dollars to certified HUBZone business.

## Footnotes

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# 13/ Finance

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SOURCE: [Energepic](#).

## Overview: Entrepreneurial Finance

*Learning Objectives*

Distinguish between financing and accounting

Describe common financing strategies for different stages of the company lifecycle: personal savings, personal loans, friends and family, crowdfunding, angel investors, venture capitalists, self-sustaining, private equity sales, and initial public offering

Explain debt and equity financing and the advantages and disadvantages of each

The case of iBackPack shows that entrepreneurial success is not guaranteed simply because a company can secure funds. **Funds** are the capital to get a business, or idea, off the ground. But funding cannot make up for a lack of experience, poor management, or a product with no viable market. Securing funding is one of the first steps for starting a business.

Let us begin by exploring the financial needs and funding considerations for a simple organization. Imagine that you and your college roommate have started your own band. In the past, you have always played in a school band where the school provided the instruments. Thus, you will need to start by purchasing or leasing your own equipment. You and your roommate identify the necessities (guitars, drums, microphones, amplifiers, and so on). In your excitement, you browse for these items online, adding to your shopping cart as you select equipment. You soon realize that even the most basic equipment could cost several thousand dollars. Do you have this much money available to make the purchase right now? Do you have other funding resources, such as loans or credit? Should you consider leasing most or all the instruments and equipment? Would family or friends want to invest in your

venture? What are the benefits and risks associated with these funding options?

This same basic inquiry and analysis should be completed as part of every business plan. First, you must determine the basic requirements for starting the business. What kinds of equipment will you need? How much labour and what type of skills? What facilities or locations would you require making this business a reality? Second, how much do these items cost? If you do not possess an amount of money equal to the total expected cost, you will need to determine how to fund the excess amount.

Once a new business plan has been developed or a potential acquisition has been identified, it is time to think about **financing**, which is raising money for an intended purpose. Here, the purpose is to launch a new business. Typically, those who can provide financing want to be assured that they could, at least potentially, be repaid in a short period, which requires a way that investors and business owners can communicate how that financing would happen. This brings us to accounting, which is the system business owners used to summarize, manage, and communicate a business's financial operations and performance. The output of accounting comprises financial statements, discussed in [Accounting Basics for Entrepreneurs](#). Accounting provides a common language that allows business owners to understand and decide about their venture that are based on financial data, and enables investors looking at multiple investment options to make easier comparisons and investment decisions.

## Entrepreneurial Funding across the Company Lifecycle

An entrepreneur may pursue one or more different



funding. Identifying the lifecycle stage of the business venture can help entrepreneurs decide which funding opportunities are most appropriate for their situation.

From inception through successful operations, a business's funding grows generally through three stages: seed stage, early-stage, and maturity (see Figure below). A **seed stage** company is the earliest point in its lifecycle. It is based on a founder's idea for a new product or service. Nurtured correctly, it will eventually grow into an operational business, much as an acorn can grow into a mighty oak, hence the name "seed" stage. Typically, ventures at this stage are not yet generating revenue, and the founders have not yet converted their idea into a saleable product. The personal savings of the founder, plus perhaps a few small investments from family members, usually make up the initial funding of companies at the seed stage. Before an outsider invests in a business, they will typically expect an entrepreneur to have exhausted **F&F financing** (friends and family financing) to reduce risk and instill confidence in the business's potential success.

After investments from close personal sources, the business idea may build traction and attract the attention of an angel investor. **Angel investors** are wealthy, private individuals seeking investment options with a greater potential return than is traditionally expected on publicly traded stocks, albeit with much greater risk. For that reason, they must be investors accredited by the federal Securities and Exchange Commission (SEC) and they must meet a net worth or income test. Nonaccredited investors are allowed in certain limited circumstances to invest in security-based crowdfunding for startup companies. Among the investment opportunities angel investors look at are startup and early-stage companies. Angel investors and funds have boomed in the past ten years, and angel groups exist in every state.

Figure 1. Business Funding Stages



An **early-stage** company has begun development of its product. It may be a technical proof of concept that still requires adjustments before it is customer ready. It may also be a first-generation model of the product that is securing some sales but requires modifications for large-scale production and manufacturing. At this stage, the company's investors may now include a few outsider investors, including venture capitalists.

A **venture capitalist** is an individual or investment firm that specializes in funding early-stage companies. Venture capitalists differ from angel investors in two ways. First, a venture capital firm typically operates as a full-time active investment business, whereas an angel investor may be a retired executive or business owner with significant savings to invest. Venture capital firms operate at a higher level of sophistication, often specializing in certain industries and with the ability to leverage industry expertise to invest with more knowledge. Typically, venture capitalists will invest higher amounts than angel investors, although this trend may shift

as larger angel groups and “super angels” invest in venture rounds.

Private equity investment is a rapidly growing sector and generally invests later than venture capitalists. Private equity investors either take a public company private or invest in private companies (hence the term “private equity”). The ultimate goals of private equity investors are generally taking a private company public through an initial public offering (IPO) or by adding debt or equity to the company’s balance sheet and helping it improve sales and/or profits to sell it to a larger company in its sector.

Companies in the **mature stage** have reached commercial viability. They are operating in the manner described in the business plan: providing value to customers, generating sales, and collecting customer payments in a timely manner. Companies at this stage should be self-sufficient, requiring little to no outside investment to maintain current operations. For a product company, this means manufacturing a product at scale, in enormous volumes. For a software company or app provider, this means generating sales of the software or subscriptions under a SaaS model (Software as a Service) and possibly securing advertising revenue from access to the user base.

Companies at the mature stage have different financing needs from those in the previous two stages, where the focus was on building the product and creating a sales/manufacturing infrastructure. Mature companies have reached a consistent level of sales but may seek to expand into new markets or regions. Typically, this requires significant investment because the proposed expansion can often mirror the present level of operations. An expansion at this level may cause doubling the size of the business. To access this amount of capital, mature companies may consider selling a portion of the company, either to a private equity group or through an IPO.

An **initial public offering (IPO)** occurs when a first-time company offers ownership shares for sale on a public stock exchange, such as the New York Stock Exchange. Before a company executes an IPO, it is privately held, usually by its founders and other private investors. Once the shares are available to the public through a stock exchange, the company is considered being publicly held. This process typically involves an investment banking firm that will guide the company. Investment bankers will solicit institutional investors, such as State Street or Goldman Sachs, which will sell those shares to individual investors. The investment banking firm typically takes a percentage of the funds raised as its fee. Benefits with an IPO is that the company gains access to a massive audience of potential investors, but the downside is owners giving up more ownership in the business and subject to many costly regulatory requirements. The IPO process is highly regulated by the SEC, which requires companies to provide comprehensive information upfront to potential investors before completing the IPO. These publicly traded companies must also publish quarterly financial statements, which are required to be audited by an independent accounting firm. If the company does not meet investors' expectations, the value of the company can decline, further hindering its future growth options.

A business's lifecycle stage influences its funding strategies and so does its industry. Different industries have varying financing needs and opportunities. For example, if you were interested in opening a pizzeria, you would need a physical location, pizza ovens, and furniture so customers could dine there. These requirements translate into monthly rent on a restaurant location and the purchase of physical assets (i.e. ovens and furniture). This type of business requires a higher investment in physical equipment than a service business, such as a website development firm. A website developer could work from home and potentially begin a business with minor

investment in physical resources, but with a significant investment of their own time. Essentially, the web developer's initial funding requirement would simply be several months' worth of living expenses until the business is self-sufficient.

Once we understand where a business is in its lifecycle and which industry it operates in, we can get a sense of its funding requirements. Business owners can gain funding through different avenues, each with its own advantages and disadvantages (see [Special Funding Strategies](#)).

## Types of Financing

Although many types of individuals and organizations can provide funds to a business, these funds typically fall into two categories: debt and equity financing (see Table below). Entrepreneurs should consider the advantages and disadvantages of each type as they determine which sources to pursue to support their venture's immediate and long-term goals.

Table 1. Debt vs. Equity Financing

	Debt Financing	Equity Financing
Ownership	Lender does not own stake in company	Lender owns stake in company
Cash	Requires early and regular cash outflow	No immediate cash outflow

# Debt Financing

**Debt financing** is borrowing funds from another party. Ultimately, this money must be repaid to the lender, usually with interest (the fee for borrowing someone else's money). Debt financing may be secured from many sources: banks, credit cards, or family and friends, to name a few. The maturity date of the debt (when it must be repaid in full), the payment amounts and schedule over the period from securement to maturity, and the interest rate can vary widely among loans and sources. You should weigh all these elements when considering financing.

The advantage of debt financing is that the debtor pays back a specific amount. When repaid, the creditor releases all claims to its ownership in the business. The disadvantage is that repayment of the loan typically begins immediately or after a short grace period, so the startup faces a quick cash outflow requirement, which can be challenging.

One source of debt financing for entrepreneurs is the Small Business Administration (SBA), a government agency founded as part of the Small Business Act of 1963, whose mission is to “aid, counsel, assist and protect, where possible, the interests of small business concerns.”<sup>178</sup> The SBA partners with lending institutions such as banks and credit unions to guarantee loans for small businesses. The SBA typically guarantees up to 85% of the amount loaned. Whereas banks are traditionally wary of lending to new businesses because they are unproven, the SBA guarantee takes on some of the risk that the bank would normally be exposed to, providing more incentive to the lending institution to finance an entrepreneurial venture.

To illustrate an SBA loan, let us consider the 7(a) Small Loan program. Loans backed by the SBA typically fall into one of two categories: working capital and fixed assets. **Working capital** is simply the funds a business has available for day-

to-day operations. If a business has only enough money to pay bills that are currently due, that means it has no working capital, a precarious position for a business to be in. A business in this position may want to secure a loan to help see it through leaner times. **Fixed assets** are major purchases like land, buildings, equipment, and so on. The amounts required for fixed assets would be significantly higher than a working capital loan, which might cover just a few months' expenses. As we will see, loan requirements made under the 7(a) Small Loan program are based on loan amounts.

For loans over \$25,000, the SBA requires lenders to demand collateral. **Collateral** is value that a business owner pledges to secure a loan, meaning that the bank has something to take if the owner cannot repay the loan. Thus, in approving a larger loan, a bank might ask you to offer your home or other investments to secure the loan. In a real estate loan, the property you are buying is the collateral. Loans for larger purchases can be less risky for a bank, but this can vary widely from property to property. A loan that does not require collateral is referred to as unsecured.



SOURCE: [Anthony Shkraba](#).

To see how a business owner might use an SBA loan, let us return to the example of a pizzeria. Not all businesses own the buildings where they operate; in fact, many businesses simply rent their space from a landlord. Here, a smaller loan would be needed than if the business owner were buying a building. If the prospective pizzeria owner could identify a location available for rent that had been a restaurant, they might need only to make superficial improvements before opening to customers. This is a case where the smaller, collateral-free type of SBA loan would make sense. Some funds would be allocated for improvements, such as fresh paint, furniture, and signage. The rest could pay employees or rent until the pizzeria has sufficient customer sales to cover costs.

Besides smaller loans, this SBA program also allows for loans up to \$350,000. Above the \$25,000 threshold, the lending bank must follow its own established collateral procedures. It can be difficult for a new business to provide collateral for a larger loan if it does not have significant assets to secure the loan. For this reason, many SBA loans include the purchase of real estate. Real estate can be accepted as collateral because it cannot move and holds its value yearly. For the pizzeria, an aspiring business owner could take advantage of this higher level of lending when the business is buying the property where the pizzeria will be. Here, most loan proceeds will probably go toward the purchase price of the property. Both the high and low tiers of the SBA loan program are examples of debt financing. In [Special Funding Strategies](#), we will look at how debt financing differs from equity financing.

## Equity Financing

In terms of investment opportunities, equity investments are those that involve purchasing an ownership stake in a company, usually through shares of stock in a



corporation. Unlike debts that will be repaid and thus provide closure to the investment, **equity financing** is financing provided in exchange for part ownership in the business. Like debt financing, equity financing can come from unique sources, including friends and family, or more sophisticated investors. You may have seen this type of financing on the TV show *Shark Tank*. Contestants on the series pitch a new business idea to raise money to start or expand their business. If the “sharks” (investors) want to invest in the idea, they will make an offer for an ownership stake. For example, they might offer to give the entrepreneur \$200,000 for a return of 40% ownership of the business.

The advantage of equity financing is that there is no immediate cash flow requirement to repay the funds, as there is with debt financing. The drawback of equity financing is that the investor in our example is entitled to 40% of the profits for all future years unless the business owner repurchases the ownership interest, typically at a much higher **valuation**, an estimate of worth, usually described in relation to the price an investor would pay to acquire the entire company.

This is illustrated in the real-life example of the ride-sharing company Uber. An early investor in the company was Benchmark Capital, with an initial investment of \$12 million in Uber in exchange for stock. That stock, as of its IPO date in May 2019, was valued at over \$6 billion, which is the price that the founders would have to pay to get Benchmark’s share back.

Some financing sources are neither debt nor equity, such as gifts from family members, funds from crowdfunding websites such as Kickstarter, and grants from governments, trusts, or individuals. The advantages and disadvantages of these sources are discussed in [Special Funding Strategies](#).

## Special Funding Strategies



SOURCE: [Matthias Zomer](#).

### *Learning Objectives*

Identify funding strategies used by charitable organizations

Describe financing opportunities available to startups

Define bootstrapping

Describe the advantages and disadvantages of bootstrapping

It is important to recognize that not all startups are Silicon Valley tech companies. These companies create high-profile products, such as applications and websites, which can

take years to become profitable or even generate revenue. Much more common are the small businesses founded every day by entrepreneurs seeking to create value in their local communities. Not all startups are founded with a profit motive in mind.

**Charitable organizations**, or certain non-profit companies, are often founded for altruistic purposes, such as advancing the arts, education, and science; protecting the natural environment; providing disaster relief; and defending human rights (see Table below).

Table 2. Charitable Missions and Example Organizations

Mission	Examples
Advance education	Teach for America, Khan Academy
Protect the natural environment	Sierra Club, Wildlife Conservation Society
Defend human rights	Amnesty International, Human Rights Watch
Provide disaster relief	American Red Cross
Support the arts	Metropolitan Museum of Art, Americans for the Arts

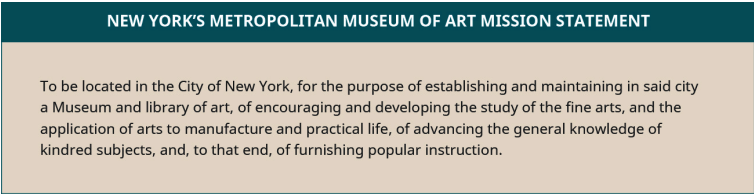
These goals supersede the profit motive that a traditional company would have. As a result, the funding strategies of these enterprises often differ dramatically from those of standard for-profit businesses. Without the emphasis on profit, it's difficult to provide for the cost of ongoing operations. Thus, these organizations must develop

a **sustainable strategy**, one that can maintain the organization’s financial stability.

In the United States, such organizations can qualify for **tax-exempt status**, meaning that if there is a profit from operations, it is not typically subject to taxes. Organizations seeking this exemption must apply to the Internal Revenue Service for tax-exempt status and provide information about what kind of mission the organization carries out (charitable, scientific, educational, and so on).

Consider a museum. What is its purpose? Traditional companies provide a product or service to their customers for payment and typically fill a need their customers have. A grocery store sells food because human beings need to eat food to survive. Although viewing paintings and sculptures is not a physical requirement for life, this experience arguably enriches our lives and helps educate and shape our society. That is why museums are founded. Consider the original mission statement of the Metropolitan Museum of Art (commonly known as the “Met”) in New York City (see Figure below).<sup>179</sup>

Figure 2. NYMMA Mission Statement



*SOURCE: The mission statement of New York’s Metropolitan Museum of Art. (attribution: Copyright Rice University, OpenStax, under CC BY 4.0 license).*

This is a different goal than most small businesses (providing a product or service for a profit) and, as a result, requires different financing strategies, such as a combination of program services, donations, and grants.



Go to the Internal Revenue Service’s website and look

at the [most recently updated Pub 334 Tax Guide for Small Business](#) to learn more about the rules for income tax preparation for a small business.

## Program Services

**Program services** are the basic offerings that a non-profit organization provides that result in revenue, although not typically enough to cover the overall cost of running the organization. These services most closely resemble the customer interactions of a traditional business. The organization provides a product or service for a customer's money.

In our museum example, program services could take a few different forms. First, the museum likely charges a fee for admission to view the artwork and artifacts. The individual ticket price multiplied by the number of museum visitors equals the museum's ticket revenue. An established museum will have a sense of how many visitors it has on average and create a budget accordingly.

Another source of program service revenue for a museum could take the form of hands-on educational activities or events with guest speakers or presenters. Often museums will host local artists, or their own employees might conduct art classes or special-topic tours. These events and activities typically have a charge (revenue) beyond the regular admission cost.

Despite these revenue-generating activities, non-profit organizations still face many funding challenges in covering all the operating costs of a normal business, such as employee wages, facility costs, and advertising. Thus, they need many sources of income. To illustrate, the Met's 2018 program service income only made up 2.3% of its total revenue for the year.<sup>180</sup>

## Donations

One benefit to a business with a charitable mission is inherent public support, which can foster community involvement above and beyond patronage. For non-profits, this can translate into a willingness to donate money to the organization. A **donation** is a financial gift with no expectation of repayment or receiving anything in return. A traditional business must provide something valuable to create a customer exchange: Their customers demand value for their hard-earned money.

The benefactors of a charitable organization want to help further the mission of the organization. This type of entity (whether it is a museum, a hospital, or the Red Cross) relies on the goodwill of community supporters. For the Met, with a low percentage of revenue generated by program services, donations, and charitable gifts are vital to the organization's **financial viability**.

## Grants

Another source of funding for non-profit organizations is grants. A **grant** is a financial gift given for a specific purpose by a government agency or a charitable organization such as the Bill and Melinda Gates Foundation. Like a donation, a grant does not have to be repaid. Unlike with donations, both non-profit and for-profit organizations can compete for grants. Whereas donations are typically given without restriction to offset the general operating expenses of the organization, grants often specify how the funds are to be used. Most grant-providing entities have an agenda or purpose behind their funding. For example, the National Institutes of Health (NIH) provides grants "to support the advancement of the NIH

mission to enhance health, extend healthy lives, and reduce the burdens of illness and disability.”<sup>181</sup> This federal organization invests over \$32 billion annually for medical research.

Grants can be very competitive, requiring a rigorous application process. Usually, multiple organizations apply for the same grant; the organization issuing the grant reviews the many competing applications to make its selection. Grantees generally must submit audited financial statements and are required to update the grantor after the grant award to ensure proper intended use. The NIH awards almost 50,000 grants annually, most of which are competitive. Although that is an enormous number of projects to fund, only 20% of applications submitted to the NIH in 2018 were accepted.<sup>182</sup> The NIH rejected four out of every five applications. For entrepreneurs, this means that when you identify a grant that is specific to your organization’s mission, weigh your chances of being awarded the grant when considering it as part of your funding strategy.

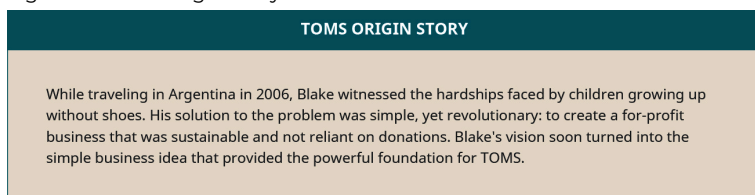
To understand grants let us further examine the NIH. The NIH Small Grant Program provides funds for activities such as the development of new research technology. This specific grant can be awarded for up to a two-year period, with funds of up to \$50,000 in direct costs per year. A grant like this could provide vital support to a non-profit startup.

Some business ventures fall somewhere between organizations completely committed to charitable work and traditional small businesses with entrepreneurs focused on social entrepreneurship. Social entrepreneurs develop products and services as solutions to societal problems. For example, the TOMS shoe company could create a business model through which the company gives one pair of shoes to children in need in foreign countries for every pair of shoes purchased, known as “One for One.”<sup>183</sup>

The company’s website describes the origins of both the company and this model, which are based on the

experiences of its founder, Blake Mycoskie (see Figure below).<sup>184</sup>

Figure 3. TOMS Origin Story



SOURCE: The TOMS origin story provides an example of social entrepreneurship. (attribution: Copyright Rice University, OpenStax, under CC BY 4.0 license)

Social entrepreneurship offers the ability to effect positive change in the world without simply relying on donations. It pairs a profitable, sustainable business model with a good cause. This combination often creates positive word-of-mouth. It gives potential customers a good feeling about the product beyond just its style or function.

## What Can You Do? Social Entrepreneurship

Like the founder of TOMS, sometimes in our everyday life, we are presented with an opportunity to help people. We may even find out that we are not alone in this desire to help. What opportunities to help (individuals, society, or environment) do you see in your own community? What are some ways that you could raise awareness around this issue?

## No-Loan Finance Strategies

As you have learned, many startups come into being through the extensive use of debt. Although borrowing is a legitimate source of funding, it can be risky, especially if the



entrepreneur is personally responsible for repayment. Some entrepreneurs max out credit cards, take out home-equity loans against their primary residences, or secure other high-interest personal loans. If the entrepreneur cannot repay the loans, the result can be repossession of equipment, home foreclosure, and other legal action.

We now examine funding strategies attractive to many startups that do not require going into debt or exchanging ownership of the business for financial support (debt and equity financing). The financing methods described here are more creative funding strategies, including crowdfunding, bartering, and other methods.



SOURCE: [Ryutaro](#).

## Crowdfunding

Recall the story of iBackPack. This venture was originally funded by contributions through Indiegogo and

Kickstarter. These websites are a form of **crowdfunding**, which involves collecting small sums of money from many people. The people who contribute money are typically referred to as backers because they are backing the project or supporting the business idea.

Browsing these crowdfunding websites, you will see many kinds of ventures seeking financial backing, from creating new board games to opening donut cafes. Each project identifies an overall specific funding goal in terms of a dollar amount. Some crowdfunding websites, such as Kickstarter, implement an “all or nothing” model in which projects do not receive any funds unless their overall funding goal is met. The amount can be exceeded, but if it is not met, the project receives nothing. For an entrepreneur using this resource, selecting an attainable funding goal must be a core part of their strategy. The funding goal must also be appropriate to the scale of the project. For example, setting a goal of \$50,000 may be reasonable for launching a food truck (which could be a prototype for a full restaurant), but it is a mere fraction of the cost of constructing an entire table-service restaurant, which would come closer to \$750,000. An entrepreneur entering the culinary world should consider which target would be most achievable as well as most beneficial in meeting both short- and long-term goals. Also, remember that meeting the funding goal does not ensure success of the business, as with iBackPack.

Entrepreneurs vying for crowdfunding usually employ some common tactics. First, they often post an introductory video that explains the project goal and the specific value proposition (i.e. a chef might seek \$75,000 to open a food truck specializing in a relatively unknown cuisine). Second, the entrepreneur provides a more detailed written summary of the project, often including specific items that the funding will pay for, such as \$50,000 for a vehicle, \$10,000 for graphic design and vehicle decals, and \$15,000 for kitchen equipment for the

truck. Last is the reward structure, which is what entices visitors to the site to fund the project, offering a return beyond their own passion for the venture. The reward structure establishes different levels of funding and ties a specific reward to each level. For example, for a contribution of \$5, the chef might thank the backer on social media; for \$25, the backer would get a t-shirt and a hat featuring the food truck's logo; for \$100, the backer would get five free meals when the food truck opens. Fees for these crowdfunding sites vary from 5% to 8%. Kickstarter now requires physical products or prototypes for some startups, as well as a short video to help represent and "sell" the product.

Although this financing source offers a lot of flexibility, businesses using crowdfunding can run into trouble. Certain funding levels and rewards may have limits. For example, a reward structure might offer backers contributing \$1,000 a trip to the grand opening of the food truck, including airfare and hotel. These top-tier rewards can generate a lot of excitement, but the expense of flying people around the country and providing accommodations could become unmanageable. One research study stated that 84% of Kickstarter's top projects delivered their rewards late.<sup>185</sup>

The advantage of crowdfunding is that the business receives cash up-front to launch. The downside is that the reward requires a future payment to the backers. This payment may be as branded merchandise, meals, or even events or travel, so it is important for entrepreneurs to set aside part of the investment money to fund the rewards. Depending solely on generating the reward funds out of future sales is a risk that might cause upsetting the fans who made the business possible. Since crowdfunding is managed online, another risk is upsetting the project's vocal supporters. Crowdfunding usually provides only a "kick start" for a startup, most seed stage companies need additional funding from other sources for their first commercial launch.

Although social media can backfire, entrepreneurs can take advantage of benefits too. Crowdfunding can allow an entrepreneur to build a community around a product before it is even sold. Like-minded fans of a product can connect with each other over the internet, in the feedback section of a website, or in shared social media posts. Backers of a project can become cheerleaders for it by sharing the idea (and their enthusiasm for it) with friends, family, and coworkers. Word-of-mouth marketing can lead to more backers or future customers after launch.

Dozens of crowdfunding portals exist, including WeFunder, SeedInvest, Kickstarter, and Crowdcube. Current SEC guidelines<sup>186</sup> for issuing and investing limits granted for Title III Crowdfunding include:

A company can raise up to \$1 million in aggregate through crowdfunding offerings over a 12-month period.

Over a 12-month period, individual investors can invest in the aggregate across all crowdfunding offerings up to:

\$2,000 or 5% of the unaccredited investors net worth or yearly income if they make less than \$100,000/year.

10% of the lesser of their annual income or net worth, if both their annual income and net worth are equal to or more than \$100,000.

## Kickstarter



Visit the Kickstarter website at <https://www.kickstarter.com/> and review a few projects. What did they do well in the video pitch? What unique rewards did they offer? How would you implement a Kickstarter page for your own business idea?

## Bartering

Startup companies rarely have a lot of cash assets on hand to spend, but they often have offerings that can provide value to other businesses. **Bartering** is a system of exchanging goods or services for other goods or services instead of for money. Let us consider the case of Shanti, a website designer who wants to start a business. She may want to have her business formally incorporated or may require other legal help, such as review of standard contracts. Hiring a lawyer outright for these services can be costly, but what if the lawyer needed something the website designer could provide?

Whether the lawyer has just started his own business or has been established for several years, he may need a website created or have an old website redesigned and updated. This website overhaul could prove costly for the lawyer. But what if there were a way that both the lawyer and the web designer could get what they wanted with a resulting net cost of zero dollars? Bartering can achieve this. It should be noted there are accounting and tax implications involved with bartering that can prevent a net zero offset of costs.

In a barter scenario, Shanti could create a website for the lawyer at the expense only of her time, which in the startup phase is often more abundant than actual cash. The lawyer could provide incorporation services or contract review in exchange, requiring no cash outlay. For many entrepreneurs, this type of exchange is appealing and enables them to meet business needs at a lower perceived cost. Although more mature firms can also use bartering, the opportunity cost is much higher. If a mature company cannot take on a new paying client because it is doing too much free (barter) work, it may lose out on future revenue, which might be a big loss. Startups, in contrast, often have excess capacity while they develop a customer base, so taking on barter work is often a low-risk, beneficial funding strategy.

## Other No-Loan Funding Options

Beyond crowdfunding and bartering, startups have other options to help them get off the ground, such as funding competitions and pre-orders (see Figure below). Many organizations hold entrepreneurial finance contests provide financial awards to the winners. These prize funds can seed money to start a new venture. For example, the New York City Public Library holds an annual business plan competition called the New York StartUP! Business Plan Competition.<sup>187</sup> Applicants must complete an orientation session, attend workshops that develop skills related to the creation of a business plan, and submit a complete business plan. The first-place award yields \$15,000 in prize money, which can be a splendid start toward turning an entrepreneurial idea into a business reality.

Another way for startups to gain financial traction is to solicit pre-orders. Consider the launch of a new book or video game. Retail stores will often solicit pre-orders, which are advance purchases of the product. Customers pay for the desired item before they even have access. For example, the entrepreneur Mitchell Harper raised \$248,000 in funds before his product launched.<sup>188</sup> This approach is not limited to existing, well-known franchises, startups can use it as well. Although established novel and video game franchises have large fan bases and often large advertising budgets, startups can still find effective strategies in this space.

Figure 4. No-loan Funding Options



*SOURCE: Entrepreneurs can explore a variety of no-loan funding options. (attribution: Copyright Rice University, OpenStax, under CC BY 4.0 license)*

Companies with a prototype model of their product or a first manufacturing run can showcase the new product to potential customers, who may be interested enough to place an order. The company can use the funds received from these pre-orders to pay for the inventory. Besides having sales staff make sales calls, new companies can attend trade shows and exhibitions to garner interest in the product. Many new products are launched in this fashion because it allows access to many potential customers in one place.

## Why Bootstrapping Hurts, Then Helps

The process of self-funding a company is typically referred to as **bootstrapping**, based on the adage that urges us to “pull ourselves up by our bootstraps.” It describes a funding strategy that seeks to optimize use of personal funds and other creative strategies (such as bartering) to minimize cash outflows. In recent years, this strategy has been the fodder for shows like *Shark Tank*. These shows may make entrepreneurs think that being on TV is glamorous, or the shows may glorify the financial backing of millionaires and billionaires. We have seen that for many entrepreneurs there are drawbacks to bringing in outside investors to launch your venture. These drawbacks include loss of future profits and control of the company, among others. Potential business owners must weigh the advantages and disadvantages (both short- and long-term) for funding their specific dream.

You have learned about financing strategies predicated on finding a willing investor or lender, but many small businesses simply do not have access to large amounts, or any amount, of capital. In these cases, aspiring business owners need lean business strategies that will yield the greatest benefit.





SOURCE: [Fauxels](#).

Bootstrapping requires entrepreneurs to shed any preconceived notions of the popular-culture image of startups. Most startups do not have trendy downtown offices, foosball tables, or personal chefs. Bootstrapping reality looks more like late nights spent clipping coupons. It involves scrutinizing potential expenses and whether each cost is worth the investment. It can be a difficult and trying to process, but with no angel investors or wealthy family backers, bootstrapping is often an entrepreneur's only option. The good news is that this approach can pay substantial dividends in the long run.

## The Basics of Bootstrapping

When entrepreneurs risk their life savings, they must stretch every dollar as far as possible. Having a limited amount of capital to work with requires optimizing creative strategies to get the business launched and keep it afloat. This creativity

applies to bringing customers and sales in the door and to managing expenses.

Understanding the ongoing costs of the business is key. In an interview on NPR's show *How I Built This*, Barbara Corcoran, one investor on *Shark Tank*, shares her humble beginnings in real estate brokerage.<sup>189</sup> One of things she touches on is being constantly aware of how long her money would last, given her monthly expenses. If she had \$10,000 in the bank and the cost of her rent and employees was \$2,500 per month, she knew that the money would last her four months. Such constant information and vigilance are required when bootstrapping a business for success.

Employee costs are typically one of the largest expenses facing a business. Hiring traditional full-time employees can be costly; onboarding them too early can be fatal to a business's bottom line. Creative approaches to minimizing labour costs can be enormously helpful. One strategy for controlling these costs is using independent contractors (freelancers) and other part-time employees. They do not work full-time for the business and may serve other companies as well. Their compensation is generally lower than that of a full-time, salaried employee, often in part because these positions rarely come with any benefits, such as health insurance or paid time off. Using these workers to fill resource needs can help minimize costs. Once operations have stabilized, it may be possible and ideal to offer full-time employment to these individuals.

Marketing is another key area for new business investment, but billboards, web ads, TV ads, and radio spots can be expensive. TV and radio ads can also be ineffective if they are aired during low-volume times, which is typically all that startups with lower budgets can afford. Fortunately, there are many low- or no cost marketing opportunities, such as word-of-mouth marketing. Doing a good job for one customer can easily lead to referrals for more business. Some social media

efforts can also provide a strong return for minimal investment, although typically it is nearly impossible to gauge an effort's potential impact or success.

A new enterprise that is bootstrapping must also carefully manage operational expenses. At the beginning of operations, an entrepreneur can often minimize unnecessary expenses, even if that means forgoing an actual business location. Working out of a home office or a co-working space (such as WeWork or Impact Hub) can lead to significant savings. Renting office space can cost hundreds or thousands of dollars a month, whereas a home office typically requires no additional investment. Depending on the location, co-working spaces can provide a single workspace and technology access for as little as \$50 to \$100 per month, yielding substantial savings over a dedicated office suite. In larger cities, or in locations with more amenities, the monthly costs can run between \$100 and \$500 per month.

The Boston Beer Company, which today produces the Samuel Adams line of beers, provides a classic example of minimizing these costs in its early days. When this company first started, it owned no office space, or even a brewery. It employed other breweries as contract brewers to manufacture its beer. Its founder, Jim Koch, invested most of his time in selling to bars and restaurants, working from his car and phone booths (This was during the 1980s). His lean strategy was a successful application of the bootstrapping mindset. From its humble beginnings, the Boston Beer Company has become one of the largest American-owned breweries, ranked second based on 2018 sales volume by the Brewers Association.<sup>190</sup> Whereas traditional thinking may dictate that a company must have an official office or headquarters, a bootstrapping mindset evaluates what the space would be used for and the trade-offs for its cost.

# How Bootstrapping Hurts

Bootstrapping is not easy and fraught with tight budgeting and sacrifice, which can take its toll on an entrepreneur. One of the simplest bootstrapping strategies is to start a business by **moonlighting** or treating your business venture as a second job. Employing this strategy, the entrepreneur continues to work at their regular job, say from 9:00 a.m. to 5:00 p.m. and then dedicates the rest of the evening and weekends to working on the business. Whereas this strategy has the obvious benefit of maintaining a comfortable level of income, this approach has a few drawbacks (see Table below). Moonlighting entrepreneurs cannot dedicate 100% of their time and energy to their new business. The time they can dedicate to it may be less efficient. After working all day at another job, a person may feel tired or burned out, so it is difficult to change gears and press forward with full productivity.

Table 3. Bootstrapping Advantages and Disadvantages

Advantages	Disadvantages
No ownership given up Forces creative solutions Keeping costs low fuels growth	Slow to start Less glamorous Owner must make personal sacrifices

Besides the exhausting time investment, moonlighting can exact tolls on personal relationships. This strategy is easiest when an entrepreneur is in a life stage with few commitments. It may have an adverse effect on friendships, but in other life stages, this impact can be more significant. For example, it can detract from relationships with a partner/spouse or children, in both a decrease in focus/

investment in these relationships and day-to-day challenges in worklife balance and household management for all affected. At some point, to attract serious investors, a founder will have commit to the project full-time.

Other bootstrapping strategies include negotiating the terms for payments on expenses. When businesses sell to other businesses, the vendor allows the customer to buy on **credit**. This means that the buyer does not have to pay at the time of purchase. Although retail customers are required to pay at the register during checkout, purchases between businesses can work on different terms, sometimes extended up to 30, 60, or 90 days. This extra time to pay for purchases can be a real advantage for businesses. When a business buys inventory on credit, it can begin selling it before it has even paid for it. For example, a clothing retailer could sell its product in stores or online and receive cash before it had to pay its vendors. Unfortunately, when a business's cash becomes tight, an ethical dilemma can arise. When a business has more bills to pay than money to pay them with, the owner will need to make tough decisions. Ultimately, when vendors will no longer sell to you on credit, or even at all. When a company can no longer buy inventory to sell to customers, it will not be long until it is out of business. An ethical entrepreneur will alert to this concern and resolve it with aboveboard business decisions.

## How Bootstrapping Helps

Although bootstrapping can be painful in the early years of a business, it yields significant benefits for the business owner in the future. One of the most valued benefits of bootstrapping a business is the fact that the founder can maintain control of the company and typically keep 100% ownership. Although it's easy to give up ownership in an idea because ideas come freely and don't require financial sacrifice,

entrepreneurs who accept an equity financing opportunity and give up a significant portion of ownership of the business may not realize the potential detrimental outcomes. What seems glamorous on *Shark Tank* may cost a business owner more control than desired. Once you give up any amount of equity in a business, it can be difficult or expensive to get it back. Once the deal is accepted, the investor is entitled to that percentage of the profit every year the company is in business, even if that person never lifts a finger to support the enterprise. Entrepreneurs usually make those financing deals because of the benefits of the money and access to the investor's contacts. It is unlikely that Mark Cuban is going to roll up his sleeves in your food truck when things get tough. If you can avoid outside financing, you will maintain complete control and full ownership of the business and weigh this benefit in your financing decisions.

Another benefit of bootstrapping is avoiding taking on debt. Whether it is credit cards or personal loans, repayment of debt can take a serious toll on any business and can be especially burdensome for new businesses. Considering that some of the debt financing sources available to entrepreneurs can bear higher-than-average interest rates, digging yourself out from underneath this financial burden is no simple task. Also, delaying outside investments allows your business to grow not only in revenue and profit but also in market value. When potential investors come along, they will consider a higher contribution for a smaller percentage in the business.

## Link to Learning



One of the most common forms of debt financing is simply a credit card. Although it may seem wise to charge many of the up-front expenses and simply pay the card's

minimum monthly payment, this can be a treacherous road to go down. Try the [credit card calculator](#) to calculate how long it takes to pay off a credit using only the minimum payment. It may shock you. Try a few different amounts: \$1,000; \$5,000; and \$10,000.

## Personal Finances

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SOURCE: [Suzy Hazelwood](#).

*Learning Objectives*

- Describe strategies to minimize and manage debt.
- Explain how to manage monthly income and expenses.
- Define personal finances and financial planning.
- Explain the financial planning life cycle.
- Discuss the advantages of a college education in meeting short-term and long-term financial goals.
- Explain compound interest and the time value of money.
- Discuss the value of getting an early start on your plans for saving.

## Show What You Know



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# The World of Personal Credit



SOURCE: [Pixabay](#).

Do you sometimes wonder where your money goes? Do you worry about how you will pay off your student loans? Would you like to buy a new car or even a home someday and you are not sure where you will get the money? If these questions seem familiar to you, you could benefit from help in managing your personal finances, which this chapter will seek to provide.

Let us say that you are 28 and single. You have a good education, good job, and you are making \$60K working with a local accounting firm with a \$6,000 retirement savings account, but you carry three credit cards. Your plan is to buy a condo in two or three years and take your dream trip to the world's hottest surfing spots within five years. The only big worry is your \$70,000 in student loan debt, car loan, and credit card debt. Even though you have been gainfully employed for six years now, you could not make a dent in that \$70,000. You can afford the necessities of life and then some, but you have

occasionally wondered if you are ever going to have enough income to put something toward that debt.<sup>191</sup>

You are not alone! The average student in Canada will graduate in 2018 having accumulated over \$27,000 in student debt. But this is not the only financial problem in Canada. Canadian household debt has reached a record high of over \$2.08 trillion as of September 2017, that is \$1.68 of debt for every \$1 of income.



The Organization for Economic Cooperation and Development began measuring the financial literacy of its OECD countries using a 5-question survey. [Take the survey!](#)

Personal financial literacy is more important than ever in Canada. As a country we need to improve our financial literacy. The Bank for International Settlements, an “international watchdog” regarding country economic risk, has warned that Canada’s banking system is at risk because of the rising collective household debt level. In the coming chapter you will learn the basics of personal financial literacy.

## Time is Money

You must choose a career at an early-stage in your financial lifecycle and need to start financial planning early. For instance, it is your 18<sup>th</sup> birthday, and you take possession of \$10,000 that your grandparents put in trust for you. You could spend it or cover the cost of flight training for a private pilot’s license (something you believed was unattainable right away). Your grandparent suggests that you put it into a savings account to grow your \$10,000 through interest. **Interest** is the charge for the privilege of borrowing money, typically expressed as an annual percentage rate, or is the payment made to you from the investing institution on top of the principal amount you invested of \$10,000. If you just wait until

you finish college, and if you can find a savings plan that pays 5% interest, you will have the \$10,000 plus about another \$2,000 for something else or to invest.

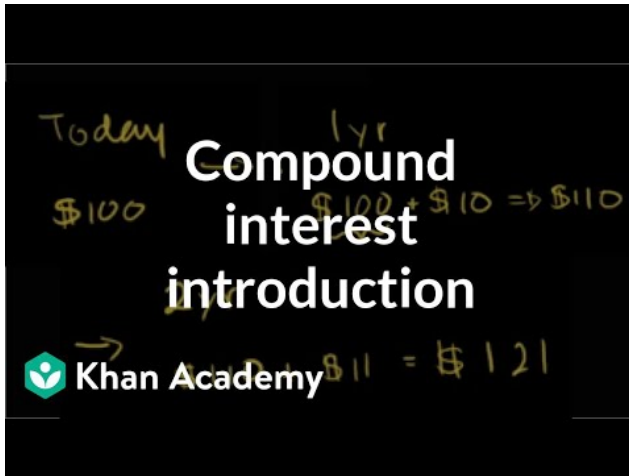
The total amount you will have, \$12,000, piques your interest. If that \$10,000 could turn itself into \$12,000 after sitting around for four years, what would it be worth if you held on to it until you retired at age 65? A quick trip to the Internet to find a compound interest calculator informs you that, 47 years later, your \$10,000 will have grown to \$104,345 (assuming a 5% interest rate). That is not enough to retire on, but it would be a good start. What if that four years in college had paid off the way you planned, so that once you get a good job, you can add, say, another \$10,000 to your retirement savings account every year until age 65? At that rate, you will have amassed a nice little nest egg of slightly more than \$1.6 million.

## Compound Interest

In your efforts to appreciate the potential of your \$10,000 to multiply itself, you have acquainted yourself with two of the most important concepts in finance. As we have already showed, one is the principle of compound interest, which refers to the effect of earning interest on your interest.

For example, that you take your grandparent's advice and invest your \$10,000 (your principal) in a savings account at an annual interest rate of 5%. Over the course of the first year, your investment will earn \$500 in interest and grow to \$10,500. If you now reinvest the entire \$10,500 at the same 5% annual rate, you will earn another \$525 in interest, giving you a total investment at the end-of-year 2 of \$11,025. That is how you can end up with \$81,496.67 at age 65.

Video 1. Khan Academy: Compound Interest Introduction



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<https://pressbooks.library.upei.ca/startup/?p=604>

([Video Link](#))

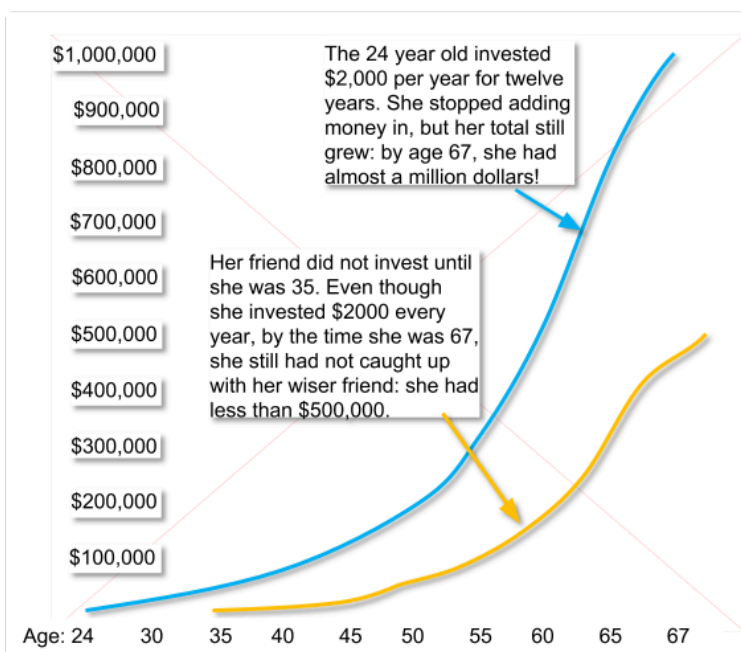
## Time Value of Money

You have also encountered the principle of the time value of money, the principle whereby a dollar received in the present is worth more than a dollar received in the future. There is one thing that we have stressed throughout this chapter so far, it is the fact that most people prefer to consume now rather than in the future. You likely borrow money from me because you cannot buy something that you want at the present time. By lending to you, I must forego my opportunity to purchase something I want at the present time, which will

only occur if I can get some compensation for making that sacrifice (charging you interest). You are going to pay the interest because you need the money to buy what you want now, leading to an understanding on how much interest should we agree on? In theory, it could be just enough to cover the cost of my lost opportunity, but there are, of course, other factors. Inflation, which is the general increase in prices of goods and services and the corresponding decrease in the purchasing power of money, for example, will have eroded the value of my money by the time I get it back from you. In addition, while I would take no risk in loaning money to the Canadian government, I am taking a risk in lending it to you. Our agreed-on rate will reflect such factors.<sup>192</sup>

Finally, the time value of money principle also states that a dollar received today earns interest sooner than one received tomorrow. Let us say, for example, that you receive \$2,000 in cash gifts when you graduate from college. At age 23, with your college degree in hand, you get a decent job and do not have an immediate need for that \$2,000. So, you put it into an account that pays 10% compounded and you add another \$2,000 (\$167 per month) to your account every year for the next 11 years.<sup>193</sup> The blue line in the graph below shows how much your account will earn each year and how much money you will have at certain ages between 24 and 67.

Figure 5. The Power of Compound Interest



As you can see, you would have nearly \$52,000 at age 36 and a little more than \$196,000 at age 50; at age 67, you would be short of \$1 million. The yellow line in the graph shows what you would have if you had not started saving \$2,000 a year until you were age 36. As you can also see, you would have a respectable sum at age 37, but less than half of what you would have accumulated by starting at age 23. More important, even to accumulate that much, you would have to add \$2,000 per year for 32 years, not just 12.

Table 4. How to save \$1,000,000 by Age 67

**Make your first payment at age:**      **And this is what you'll have to save each month:**

20	\$33
21	\$37
22	\$42
23	\$47
24	\$53
25	\$60
26	\$67
27	\$76
28	\$85
30	\$109
35	\$199
40	\$366
50	\$1,319
60	\$6,253

Here is another way of looking at the same principle. Suppose that you are 20 years old, do not have \$2,000, and do not want to attend college full-time. You are a hard worker and a conscientious saver, and one of your financial goals is to accumulate a \$1 million retirement nest egg. If you can put \$33 a month into an account that pays 12% interest compounded,<sup>194</sup> you can have your \$1 million by age 67 – if you start at age 20. As you can see from the figure above, if you wait until you are 21 to save, you will need \$37 a month. If you wait until you are 30, save \$109 a month, and if you procrastinate until you are 40, the ante goes up to \$366 a month.<sup>195</sup> Unfortunately in today's low interest rate

environment, finding 10% to 12% return is not likely. These figures illustrate the significant benefit of saving early.

The reason should be obvious: a dollar saved today not only starts earning interest sooner than one saved tomorrow (or ten years from now) but also can ultimately earn a lot more money in the long run. Starting early means in your 20s, early in stage 1 of your financial lifecycle. As one well-known financial advisor puts it, “If you’re in your 20s and you haven’t yet learned how to delay gratification, your life is likely to be a constant financial struggle.”<sup>196</sup>

## Financial Planning

Before we go any further, we need to nail down a couple of key concepts. First, just what, exactly, do we mean by personal finances? Finance itself concerns the flow of money from one place to another, and your personal finances concern your money and what you plan to do with it as it flows in and out of your possession. Essentially personal finance is the application of financial principles to the monetary decisions that you make either for your individual benefit or for that of your family.

Second, as we suggested earlier, monetary decisions work out much more beneficially when they are planned rather than improvised. Our emphasis on financial planning, the ongoing process of managing your personal finances to meet goals that you have set for yourself or your family.

Financial planning requires you to address several questions, some of them relatively simple:

- What is my annual income?

- How much debt do I have, and what are my monthly payments on that debt?

- Others will require some investigation and calculation:

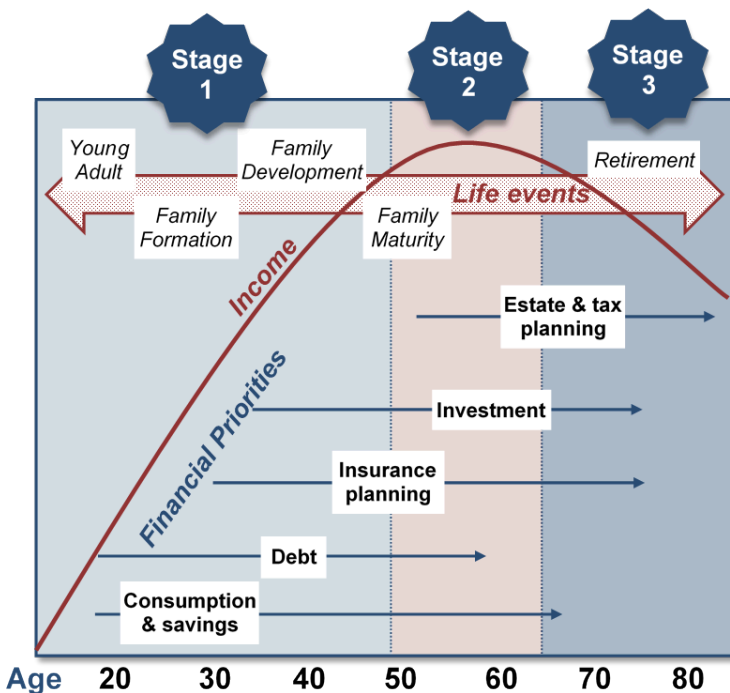
- What is the value of my assets?



How can I best budget my annual income?  
Still others will require some forethought and forecasting:  
How much wealth can I expect to accumulate during my working lifetime?  
How much money will I need when I retire?

## The Financial Planning Life Cycle

Figure 6. The Financial Life Cycle



Another question that you might ask yourself (and certainly would do if you worked with a professional in financial planning) is: “How will my financial plans change over the course of my life?” The figure above illustrates the financial life cycle of a typical individual, one whose financial outlook

and likely outcomes are probably a lot like yours.<sup>197</sup> As you can see, our diagram divides this individual's life into three stages, each of which is characterized by unique life events (such as beginning a family, buying a home, planning an estate, retiring).

At each stage, there are recommended changes in financial planning:

Stage 1 focuses on building wealth.

Stage 2 shifts the focus to preserving and increasing wealth that one has accumulated and continues to accumulate.

Stage 3 turns the focus to living on (and, if possible, continuing to grow) one's saved wealth after retirement.

At each stage, complications can set in, changes in such conditions as marital or employment status or in the overall economic outlook. Finally, as you can also see, your financial needs will probably peak somewhere in stage 2, at approximately age 55, or 10 years before typical retirement age.

## Choosing a Career

Until you are on your own and working, you are probably living on your parents' wealth right now. In our hypothetical life cycle, financial planning begins in the individual's early 20s. If that seems like rushing things, consider a basic fact of life: this is the age at which you will choose your career, not only the sort of work you want to do during your prime income-generating years, but also the lifestyle you want to live. What about college? Most readers of this book, of course, have went to college. If you have not yet decided, you need to know that college is an excellent investment of both money and time.

The table below summarizes the most recent, 2015, findings from Statistics Canada.<sup>198</sup> A quick review shows that people who graduate from high school can expect to enjoy

average annual earnings of just under \$50,000, and those who finish college can expect to generate 17% more annual income than high school graduates who did not attend college. With better access to health care, and, studies show, with better dietary and health practices, college graduates will also live longer (so will their children).<sup>199</sup>

Table 5. Education and Average Income

	Average Income: Canadian Women	Average Income: Canadian Men
High school diploma	\$43,254	\$55,774
College diploma	\$48,599	\$67,965
Bachelor's degree	\$68,342	\$82,082

What about the student loan debt that so many people accumulate? At an average cost of \$27,000 (the average amount of debt accumulated by post-secondary students upon graduation) and an average increase in earnings of \$263,000 over an average worklife expectancy of 30 years, you would need to invest that \$27,000 for 30 years at an average annual rate of return of 8%.<sup>200</sup> At that rate of return, be able to pay off your student loans (unless, of course, you cannot practice reasonable financial planning).

Naturally, there are exceptions to these average outcomes. You will find some college graduates stocking shelves at 7-Eleven, and you will find college dropouts running multibillion-dollar enterprises. Microsoft cofounder Bill Gates dropped out of college after two years, as did his founding partner, Paul Allen. Though exceptions to rules (and average outcomes) certainly can be found, they fall far short of disproving them: in entrepreneurship as in most other walks of adult life, the better your education, the more promising

your financial future. One expert in the field puts the case for the average person bluntly: educational credentials “are about being employable, becoming a legitimate candidate for a job with a future. They are about climbing out of the dead-end job market.”<sup>201</sup>

## Bringing Down Those Monthly Bills

To practice reasonable financial planning, you must first be able to identify how you can bring down your monthly bills? If you want to take a gradual approach, one financial planner suggests you perform the following “exercises” for one week:<sup>202</sup>

Keep a written record of everything you spend and total it at week’s end.

Keep all your ATM receipts and count the fees.

Take \$100 out of the bank and do not spend a penny more.

Avoid gourmet coffee shops.



SOURCE: [Tima](#).

You will probably be surprised at how much of your

money can quickly become somebody else's money. If, for example, you spend \$3 every day for one cup of coffee at a coffee shop, you are laying out nearly \$1,100 a year just for coffee. If you use your ATM card at a bank other than your own, you will probably be charged a fee that can be as high as \$3. The average person pays more than \$60 a year in ATM fees. If you withdraw cash from an ATM twice a week, you could rack up \$300 in annual fees.<sup>203</sup> Another idea is to eat out as a reward. A sandwich or leftovers from home can be just as tasty and can save you \$6 to \$10 a day. In 2013, the website DailyWorth asked three women to cut their spending in half. After tracking her spending, one participant discovered she spent \$175 eating out in just one week; do that for a year and you would spend over \$9,000!<sup>204</sup> If you think your cable bill is too high, consider alternatives like Playstation Vue or Sling. Changing channels is different, but the savings can be substantial.



**The Latte Factor** is trademarked by financial guru David Bach. He and other financial advisors recommend everyone calculate her/his latte factor. He even developed a calculator that shows how much money, over time, you could save by cutting out a small, unnecessary thing from your daily/weekly expenses. Even if you assume a low interest rate e.g., 1%, the savings add up. [Find your latte factor!](#)

You may or may not be among the Canadian consumers who purchased over 3 billion cans, 2 billion bottles and 40 million kegs of beer, in 2016 alone, or purchased one or more of the over 2 billion Tim Hortons coffees sold each year. You may not be one of the 37% of Canadian consumers that regret spending outside of your means.<sup>205</sup> Bottom line is if, at age 28, you have a good education and a good job, a \$60,000 income, and \$70,000 in debt (not an implausible scenario) there is a very good reason to think hard about controlling your debt: your level of indebtedness will be a key

factor in your ability (or inability) to reach your longer-term financial goals (i.e. home ownership, dream trip, comfortable retirement).

One of the best ways to manage your money and personal finances is to build a personal budget.

## Personal Budget

You will need to have all your information gathered. This includes what you bring in (from employment to student loans) and what goes out for food, entertainment, health and wellness, rent, utilities, etc. Be honest and thorough.

The Government of Canada, through the Financial Agency of Canada, created a tool that provides an in-depth account of your personal finances. [Use the Budget Calculator](#) to document your situation. Export your budget as an Excel spreadsheet. You will now be able to make improvements, if appropriate. If your balance is negative, or when your expenses exceed your income, you need to make some choices based on what you learned when you tracked your spending. Ask yourself some tough questions:

What can be eliminated from my expenses?

What can be reduced from my expenses?

In what areas can I be a smarter consumer?

Where does my money seem to get gobbled up?

After you have made some tough choices, turn back to the budget worksheet, and create a new “revised” column. You will want to work toward achieving a positive balance. Should you end up with a surplus or positive balance, you need to make some choices about what to do with the extra money. Perhaps you could put it toward your financial SMARTER goal. Avoid the temptation to spend it. Now let us suppose that while browsing through a magazine in the doctor’s office, you

run across a short personal-finance self-help quiz. There are six questions (recreated here):



An interactive or media element has been excluded from this version of the text. You can view it online here: [Link](#).

Personal finance experts tend to utilize the questions on the quiz: if you had 1s or 2s on any of the first three questions, you have a problem with splurging; if questions from four through six got 1s or 2s, your monthly bills are too high for your income.

## Building a Good Credit Rating

So, you may or may not have a financial problem. According to the quick test you took, do you splurge? Are your bills too high for your income? If you get in over your head and cannot make your loan or rent payments on time, you risk hurting your credit rating, your ability to borrow in the future.

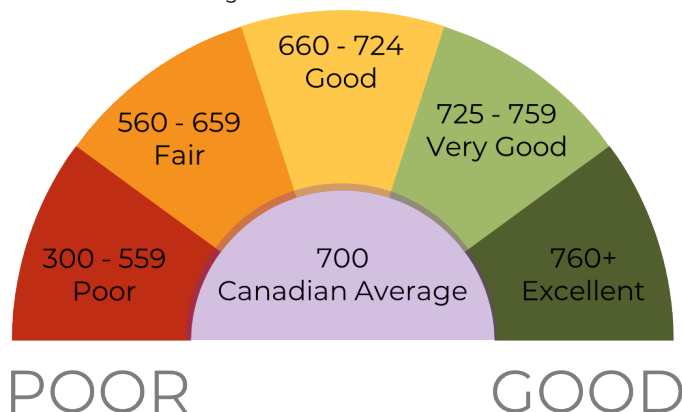
How do potential lenders decide whether you are a good or bad credit risk? If you are a poor credit risk, how does this affect your ability to borrow, or the rate of interest you must pay? Whenever you use credit, those from whom you borrow (retailers, credit card companies, banks) provide information on your debt and payment habits to two national credit bureaus: Equifax, and TransUnion. The credit bureaus use the information to compile a numerical credit score, called a FICO score; it ranges from 300 to 900, with most people falling in the 600–700 range. In compiling the score, the credit bureaus consider five criteria: the primary factors used to calculate your score:

- Payment history
- Use of available credit
- Length of credit history
- Number of inquiries

## Types of credit

The credit bureaus share their score and other information about your credit history with their subscribers.<sup>206</sup>

Figure 7. Credit Score Ranges



What does this do for you? It depends. If you pay your bills on time and do not borrow too heavily, you will probably have a high FICO score and lenders would like you, probably giving you reasonable interest rates on the loans you requested. But if your FICO score is low, lenders will not likely lend you money (or would lend it to you at high-interest rates). A low FICO score can affect your chances of renting an apartment or landing a particular job. It is very important that you do everything possible to earn and maintain a high credit score.

As a young person, how do you build a credit history that will give you a high FICO score? Based on feedback from several financial experts, Emily Starbuck Gerson and Jeremy Simon of CreditCards.com compiled the following list of ways students can build good credit.<sup>207</sup>

- Become an authorized user on a parent's account.
- Get your own credit card.
- Get the right card for you.
- Use the credit card for occasional, small purchases.



Avoid big-ticket buys, except in case of emergency.  
Pay off your balance each month.  
Pay all your other bills on time.  
Do not cosign for your friends.  
Do not apply for several credit cards at one time.  
Use student loans for education expenses only and pay on time.

If you meet the qualifications to get your own credit card, look for a card with a low interest rate and no annual fee.

## **A Few More Words about Debt**

What should you do to turn things around, to get out of debt? According to many experts, you need to take two steps:

Cut up your credit cards and start living on a cash-only basis.  
Do whatever you can to bring down your monthly bills.

Although credit cards can be an important way to build a credit rating, many people simply lack the financial discipline to handle them well. If you see yourself in that statement, then moving to a pay-as-you go basis, i.e., cash or debit card only, may be for you. Be honest with yourself; if you cannot handle credit, then do not use it.

## **Banking**

Suppose you want to save or invest; do you know where or how to do so? You probably know that your branch bank can open a savings account for you, but interest rates on such accounts can be unattractive. Investing in individual stocks or bonds can be risky and usually require a level of funds available that most students do not have. In those cases, mutual funds can be quite interesting. A mutual fund is a professionally

managed investment program in which shareholders buy into a group of diversified holdings, such as stocks and bonds. Any of the big 5 banks in Canada (RBC, CIBC, BMO, TD Canada, or Scotiabank) offer a range of investment options including indexed funds, which track with well-known indices such as the Toronto Stock Exchange, a.k.a. the TSX. Minimum investment levels in such funds can be within the reach of many students, and the funds accept electronic transfers to make investing more convenient.

You may choose to do your banking with a major bank, or with a local credit union. Most people never notice the differences between credit unions and banks. They offer similar products and services, but they are not the same. The following are some key points which highlight the differences:

Major Banks:

Funds are secure.

Profitability, usually shareholders own a bank and expect financial performance from bank management.

Offer a wide range of competitive and advanced banking products.

Inter-branch banking = convenience,

Credit Unions:

Customers are “members”; deposits are called “shares.”

Credit Unions are non-profit organizations that strive for service over profitability. They are NOT charities; credit unions must make sound financial decisions, collect revenue, pay salaries, and compete with other institutions.

May not have all the banking products as major banks.

Inter-branch banking is limited.

Funds are also secure.

## Choose an Institution that is Right for You



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As a college or university student, you might be out on your own for the first time. Part of handling your own finances will choose a banking institution or institutions that best suit your needs. Banks are eager to gain new clientele and establish brand loyalty early on. It should come as no surprise that just about every major banking institution in Canada offers student-banking plans.

Now you are ready to plan for your financial future.

### *Key Takeaways*

Credit worthiness is measured by the FICO score (or credit rating) which can range from 300 to 850. The average ranges from 680 to 719.

To maintain a satisfactory score, pay your bills on time, borrow only when necessary, and pay in full whenever you borrow.

81% of financial planners recommend eating out less to reduce your expenses.

Personal finance is the application of financial principles to the monetary decisions that you make.

Financial planning is the ongoing process of managing your personal finances to meet your goals, which vary by stage of life.

Time value of money is the principle that a dollar received in the present is worth more than a dollar received in the future because of its potential to earn interest.

Compound interest refers to the effect of earning interest on your interest. It is a powerful way to accumulate wealth.

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# 14/ Accounting

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SOURCE: [Ketut Subiyanto](#).

## Accounting and Financial Information

*Learning Objectives*



Explain the differences between managerial accounting and financial accounting.

Identify users of accounting information and explain how they use it.

Explain the function of the income statement.

Calculate revenue, expenses, and net profit.

Explain the function of the balance sheet.

Calculate assets, liabilities, and shareholders' equity.

Explain the function of the cash flow statement.

Calculate a break-even point given the information.

Evaluate a company's performance using financial statements and ratio analysis.

## Show What You Know



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## Most Valuable Player



SOURCE: [Pixabay](#).

Apple Inc. is one of the most valuable companies in the world. This statement is based on market value, which in April 2018 was roughly \$841 billion. Although markets can fluctuate, sometimes wildly, if you are reading this chapter for a course later in 2018 or in 2019, it is not unlikely that Apple will have kept its leadership position. Its value as of April 2018 was more than \$80 billion greater than that of the next largest company, Amazon. Apple has briefly ceded the leadership position to Alphabet, the parent company of Google, on a couple of occasions, but mostly, it has been the leader.<sup>208</sup>

You may wonder what kind of information is used to make these determinations. How does the market know that Apple should be valued more than \$120 billion higher than Alphabet?<sup>209</sup> Do investors just make their decisions on instinct? Well, some do, but it is not a formula for sustained success. In most cases, in deciding how much to pay for a

company, investors rely on published accounting and financial information released by publicly traded companies. This chapter will introduce you to the subject of accounting and financial information so you can understand how the valuation process works.

## The Role of Accounting

Accounting is often called “the language of business” because it communicates so much of the information that owners, managers, and investors need to evaluate a company’s financial performance. These people are stakeholders in the business, they are interested in its activities because they are affected by them. The financial futures of owners and other investors may depend heavily on strong financial performance from the business, and when performance is poor, managers may be replaced or laid off in a downsizing. In fact, a key purpose of accounting is to help stakeholders make better business decisions by providing them with financial information. You should not try to run an organization or make investment decisions without accurate and timely financial information, and it is the accountant who prepares this information. Accountants make sure that stakeholders understand the meaning of financial information, and they work with both individuals and organizations to help them use financial information to deal with business problems.

Collecting all the numbers is the simple part. The hard part is analyzing, interpreting, and communicating the information. Of course, you also must present everything clearly while effectively interacting with people from every business discipline. We are now ready to define accounting as measuring and summarizing business activities, interpreting financial information, and communicating the results to management and other decision makers.

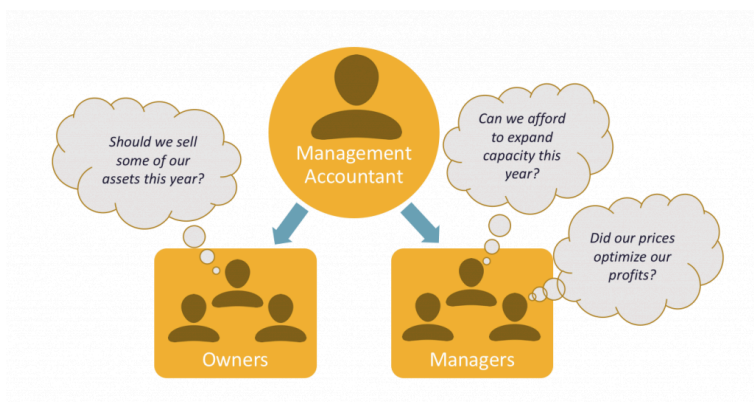
## Fields of Accounting

Accountants typically work in one of two major fields. Management accountants provide information and analysis to decision makers inside the organization to help them run it. Financial accountants furnish information to individuals and groups both inside and outside the organization to help them assess its financial performance. Their primary focus, however, is on external parties. Management accounting helps you keep your business running while financial accounting tells the outside world how well you are running it.

## Management Accounting

Management accounting, also known as managerial accounting, plays a key role in helping managers carry out their responsibilities. Because the information that it provides is intended for use by people who perform a wide variety of jobs, the format for reporting information is flexible. Reports are tailored to the needs of individual managers, and the purpose of such reports is to supply relevant, accurate, timely information that will aid managers in decide. In preparing, analyzing, and communicating such information, accountants work with individuals from all the functional areas of the organization (human resources, operations, marketing, etc.).

Figure 1. Role of Managerial Accounting



## Financial Accounting

Financial accounting prepares the organization's financial statements (income statement "profit/loss statement," statement of owner's equity, balance sheet, and statement of cash flows) that summarize a company's past performance and evaluate its current financial condition. If a company is traded publicly on a stock market such as the TSX (Toronto Stock Exchange), these financial statements must be made public, unlike the internal reports produced by management accountants.

In preparing financial statements, Canadian financial accountants adhere to a uniform set of rules called international financial reporting standards (IFRS), the basic principles for financial reporting issued by an independent agency called the Financial Accounting Standards Board (FASB). Users want to be sure that financial statements have been prepared according to IFRS because they want to be sure that the information reported in them is accurate. They also know that when financial statements have been prepared by the same rules, they can be compared from one company to another.

## Who Uses Financial Accounting Information?

The users of managerial accounting information are easy to identify (basically, they are a firm's managers). We need to look a little more closely, however, at the users of financial accounting information, and we also need to know a little more about what they do with the information that accountants provide them. Publicly Traded companies will provide their financial accounting information to a wider set of stakeholders, including shareholders, potential investors, etc., than compared to a privately held company that will generate a single set of financial statements according to the International Financial Reporting Standards. Publicly Traded companies will also provide their financial accounting information to the public to showcase to potential investors the company's performance. Therefore, Publicly Traded companies will typically generate two sets of financial statements, one set of detailed statements under Canadian International Financial Reporting Standards (IFRS) and another set of simplified financial statements that can be more easily consumed by the public. For example, Tim Hortons provides access to their simplified financial statements through annual reports which can be found at <http://www.rbi.com/Annual-Reports>

## Owners and Managers

In summarizing the outcomes of a company's financial activities over a specified period, financial statements are report cards for owners and managers. They show, for example, whether the company did (or did not) make a profit and furnish other information about the firm's financial condition. They also provide some information that managers and owners can

use to take corrective action, though reports produced by management accountants offer a much greater level of depth.

## Investors and Creditors



SOURCE: [Pete Souza](#). Warren Buffett, Presidential Medal of Freedom recipient in 2011.

Investors and creditors furnish the money that a company needs to operate, and they want to know how that business is performing. Because they know it is impossible to make smart investment and loan decisions without accurate reports on an organization's financial health, they study financial statements to assess a company's performance and to decide about continued investment.

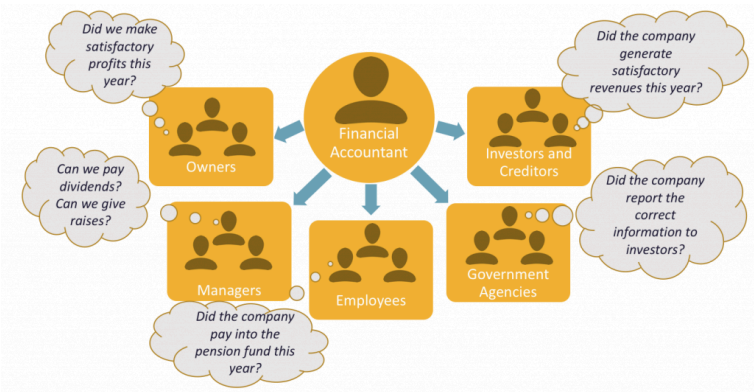
According to the world's most successful investor, Warren Buffett, the best way to prepare yourself to be an investor is to learn all the accounting you can. Buffett, chairman and CEO of Berkshire Hathaway, a company that invests in other companies, turned an original investment of \$10,000 into

a net worth of \$66 billion<sup>210</sup> in four decades, and he did it by paying close attention to financial accounting reports.

## Government Agencies

Businesses are required to furnish financial information to several government agencies. Publicly owned companies (the ones whose shares are traded on a stock exchange) must provide annual financial reports to their respective provincial Securities Commission. For example, companies in Ontario would provide financial reports to the Ontario Securities Commission (OSC), a federal agency that regulates stock trades and which is charged with ensuring that companies tell the truth regarding their financial positions. Companies must also provide financial information to the Canadian Revenue Agency (CRA).

Figure 2. The Role of Financial Accounting



## Other Users

Several other external users have an interest in a



company's financial statements. Suppliers, for example, need to know if the company to which they sell their goods is having trouble paying its bills or may even be at risk of going under. Employees and labour unions are interested because salaries and other forms of compensation depend on an employer's performance.

The previous figures illustrate the main users of management and financial accounting and the information produced by accountants in the two areas. In the rest of this chapter, we will learn how to prepare a set of financial statements and how to interpret them. We will also discuss issues of ethics in the accounting communities and career opportunities in the accounting profession.

## **Understanding Financial Statements**

We hope that, so far, at least one thing is clear: If you are in business, you need to understand financial statements. The law no longer allows high-ranking executives to plead ignorance or fall back on delegation of authority for responsibility of a firm's financial reporting. In a business environment tainted by episodes of fraudulent financial reporting and other corporate misdeeds, top managers are now being held responsible for the financial statements issued by the people who report to them. Top managers need to know how well the company is performing. Financial information helps managers identify signs of impending trouble before it is too late.

## **The Function of Financial Statements**

Put yourself in the place of Lee, who runs Lee's

Confections out of their home. They loves what they do, and feels that they are doing pretty well. In fact, Lee has an opportunity to take over a nearby store at very reasonable rent, needing to get a modest bank loan and investing more of their money. It is decision time: they know that the survival rate for startups is not good, and before taking the next step, they would like to get a better idea of whether it is worth the risk. The basic financial statements will give them some answers. Here, three common statement types are introduced.

**Income Statement** = Show's sales, expenses, and whether a profit was made.

**Balance Sheet** = Show assets and liabilities, the amount invested in the business.

**Statement of Cash Flows** = Show how much cash is coming in and going out.

Even from this basic overview, match which financial statement answers each of Lee's questions.



An interactive or media element has been excluded from this version of the text. You can view it online here: [Link](#).

Since this book is for an introductory course, attention is on the income statement, balance sheet, and cash flow statement only, even though other financial statements are mentioned.

## Toying with a Business Idea

To bring this concept closer to home, let us assume you need to earn money while you are in college and that you have started a small business. Your business will involve selling stuff to other college students, we assume that you are going to operate on a “cash” basis: you will use cash for everything, and everyone who buys something from you will pay in cash.

You may have a little cash on you right now (some

currency, or paper money, and coins). In accounting, however, the term cash refers to more than just paper money and coins. It also refers to the money that you have in chequing and savings accounts and includes items you can deposit in these accounts, such as money orders and different cheques.

Your first task is to decide exactly what you are going to sell. You have noticed that with homework, exams, social commitments, and the hectic lifestyle of the average college student, you, and most of the people you know always seem to be under a lot of stress. Sometimes you wish you could just lie back between meals and bounce a ball off the wall, and that is when the idea hits you: Maybe you could make some money by selling a product called the “Stress-Buster Play Pack.” Here is what you have in mind: you will buy small toys and other fun stuff (instant stress relievers) at a local dollar store and pack them in a rainbow-coloured plastic treasure chest labelled “Stress-Buster.”

Here is where you stand: You have enough cash to buy a month’s worth of plastic treasure chests and toys. After that, you’ll use the cash generated from sales of Stress-Buster Play Packs to replenish your supply. Each plastic chest will cost \$1.00, and you will fill each one with a variety of five simple toys, all of which you can buy for \$1.00 each.

You plan to sell each Stress-Buster Play Pack for \$10 from a rented table stationed outside a major dining hall. Renting the table will cost you \$20 a month. To make sure you can complete your schoolwork; you decide to hire fellow students to staff the table at peak traffic periods. They will be on duty from noon until 2:00 p.m. each weekday except Fridays, and you will pay them a generous \$7.50 an hour. Wages, therefore, will cost you \$240 a month ( $2 \text{ hours} \times 4 \text{ days} \times 4 \text{ weeks} = 32 \text{ hours} \times \$7.50$ ). Finally, you will run ads in the college newspaper at a monthly cost of \$40. Your total monthly costs will amount to \$300 ( $\$20 + \$240 + \$40$ ).

# The Income Statement

Let us say that during your first month, you sell 100 play packs. Not bad, you say to yourself, but did I make a profit? To find out, you prepare an income statement showing revenues, or sales, and expenses, the costs of doing business. You divide your expenses into two categories:

Cost of goods sold: the total cost of the goods that you have sold.

Operating expenses: the costs of operating your business except for the costs of things that you have sold.

Now you need to do some subtracting:

The difference between sales and cost of goods sold is your gross profit, also known as gross margin.

The difference between gross profit and operating expenses is your net income or profit, which is the proverbial “bottom line.” Note we have assumed you are making money, but businesses can also have a net loss.

Below is your income statement for the first month (in cash).

Table 3. Stress-Buster Company Income Statement

### Month Ended April 30, 2018

<b>Sales</b> (100 x \$10.00)	\$1,000
<b>Less cost of goods sold</b> (100 x \$6)	\$600
<b>Gross profit</b> (100x (\$10 – \$6))	\$400
<b>Less operating expenses</b>	
Salaries	\$240
Advertising	\$40
Table rental	\$20
	\$300
<b>Net income (Profit) (\$400-\$300)</b>	\$100

## Did You Make Any Money?

What does your income statement tell you? It has provided you with four pieces of valuable information:

You sold 100 units at \$10 each, bringing in revenues or sales of \$1,000.

Each unit that you sold cost you \$6 – \$1 for the treasure chest plus 5 toys costing \$1 each. Your cost of goods sold is \$600 (100 units × \$6 per unit).

Your gross profit (the amount left after subtracting cost of goods sold from sales) is \$400 (100 units × \$4 each).

After subtracting operating expenses of \$300 (the costs of doing business other than the cost of products sold) you have a positive net income or profit of \$100.

## The Balance Sheet

A balance sheet reports the following information:

**Assets:** the resources from which it expects to gain some future benefit

**Liabilities:** the debts that it owes to outside individuals or organizations

**Owner's equity:** the investment in the business

Your income statement tells you how much income you earned over some period, your balance sheet tells you what you have at a specific point in time.

Companies prepare financial statements on at least a 12-month basis, for a fiscal year which ends on December 31 or some other logical date, such as June 30 or September 30. Fiscal years can vary because companies generally pick a fiscal year-end date that coincides with the end of a peak selling period; thus, a crabmeat processor might end its fiscal year in October, when the crab supply has dwindled. Most companies also produce financial statements on a quarterly or monthly basis. For Stress-Buster, you'll want to prepare them monthly to stay on top of how your new business is doing. Let us prepare a balance sheet at the start and end of your first month in business.

## The Accounting Equation

To prepare a balance sheet, one must first understand the fundamental accounting equation:

$$\textbf{Assets = Liabilities + Owner's Equity}$$

This simple but important equation highlights the fact that a company's assets came from somewhere: either from investments made by the owners (owner's equity) or from loans (liabilities). This means that the asset section of the

balance sheet on the one hand and the liability and owner's-equity section on the other must be equal, or balance (balance sheet).

Let us prepare the two balance sheets we mentioned: one for the first day you started and one for the end of your first month of business. We'll assume that when you started Stress-Buster, you borrowed \$400 from your parents and put in \$200 of your own money. If you look at your first balance sheet below, you see that your business has \$600 in cash (your assets): Of this total, you borrowed \$400 (your liabilities) and invested \$200 of your own money (your owner's equity). So far, so good: your assets section balances with your liabilities and owner's equity section:

Table 4. Stress-Buster Company Balance Sheet

**As of April 1, 2018**

**Assets**

Cash	\$600
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**Liabilities and Owner's Equity**

Liabilities	\$400
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Owner's Equity	\$200
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**Total Liabilities and Owner's Equity \$600**

Now let us see how things have changed by the end of the month. Recall that Stress- Buster earned \$100 during the month of September and that you left these earnings in the business. This \$100 profit increases two items on your balance sheet: the assets of the company (its cash) and your investment in it (its owner's equity). Below shows what your balance sheet will look like on April 30. You now have \$700 in cash: \$400 that you borrowed plus \$300 that you have invested in the business

(your original \$200 investment plus the \$100 profit from the first month of operations, which you've kept in the business).

Table 5. Stress-Buster Company Balance Sheet

**As of April 30, 2018**

**Assets**

Cash (original \$600 plus \$100 earned)

**Liabilities and Owner's Equity**

Liabilities

Owner's Equity (\$200 invested by owner plus \$100 profits kept)

**Total Liabilities and Owner's Equity**

# Break-even Analysis

Let us take a brief detour to see how this information might be put to use. As you look at your first financial statements, you might ask yourself: is there some way to figure out the level of sales you need to avoid losing money, to “break-even”? This can be done using break-even analysis. To break-even (have no profit or loss), your total sales revenue must exactly equal all your expenses (both variable and fixed). Variable costs depend on the quantity produced and sold; for example, each Stress-Buster includes the treasure chest and the toys inside. Fixed costs don't change as the quantity sold changes; for example, you'll pay for your advertising whether you sell Stress-Busters. The balance between revenue and expenses will occur when gross profit equals all other (fixed) costs. To determine the level of sales at which this will occur,



you need to do the following (using data from the previous example):

Determine your total fixed costs: **Fixed costs = \$240 salaries + \$40 advertising + \$20 table = \$300**

Identify your variable costs on a per unit basis: **Variable cost per unit = \$6 (\$1 for the treasure chest and \$5 for the toys)**

Determine your contribution margin per unit: **Selling price per unit – variable cost per unit: Contribution margin = \$10 selling price – \$6 variable cost per unit = \$4**

Calculate your break-even point in units: fixed costs: **Contribution margin per unit: Break-even in units = \$300 fixed costs ÷ \$4 contribution margin per unit = 75 units**

Your calculation means that if you sell 75 units, you'll end up with zero profit (or loss) and will exactly reach even or zero. To test your calculation, you can prepare a contingent income statement for 75 units in sales (your break-even number). The resulting statement is shown in the table below. You want to do better than just break-even, so you could change this analysis to a targeted level of profit by adding that amount to your fixed costs and repeating the calculation. Break-even analysis is rather handy. It enables you to determine the level of sales that you must reach to avoid losing money and the level of sales that you must reach to earn a certain profit. Such information will be vital to planning your business.

Table 6. Stress-Buster Company Income Statement

**Month Ended April 30, 2018**  
**(at break-even level of sales = 75 units)**

<b>Sales</b> (75 x \$10.00)	\$750
<b>Less cost of goods sold</b> (75 x \$6)	\$450
<b>Gross profit</b> (75 x (\$10 – \$6))	\$300
<b>Less operating expenses</b>	
Salaries	\$240
Advertising	\$40
Table rental	\$20
<b>Net income (Profit) (\$300 – \$300)</b>	\$0

## The Cash Flow Statement

The Cash Flow Statement provides valuable information about a company's expenses and receipts and allows insights into its future income needs to meet its future obligations (expenses and receipts). Cash flow statement's report cash inflows and outflows, and it will identify the amount of cash the company currently holds, which is also reported in the balance sheet.

Typically, the cash flow statement is reported on a month-to-month basis, however, a statement of cash flow will consolidate month-to-month cash flow to meet the International Financial Reporting Standards.

A statement of cash flow will report cash in three distinct areas of business:

- Operations.

- Investing.

- Financing.

Now let us prepare the statement of cash flow for

Stress-Buster company for the one-month period ending April 30, 2018. Stress-Buster would have incurred cash from Operations as Net Income incurred after deducting the month's expenses from the month's revenues and would have also incurred cash from Financing from the initial \$400 loan taken out to start the business and the additional \$200 of personal income. As Stress-Buster did not invest in new equipment, machinery, or other assets for the business or use prior cash flows and/or kept earning to earn further investment income, Stress-Buster would not report any cash from investing activities.

Table 7. Stress-Buster Company Statement of Cash Flow

**Month Ended April 30, 2018**

Beginning Cash	\$0
Operating Activities	\$100
Net Income from Operations	\$100
Investing Activities	\$0
Financing Activities	\$600
Increase in Short-Term Debt	\$400
Increase in Retained Earnings	\$200
Ending Cash Balance (Net Change)	\$700

## Financial Statement Analysis

Now that you know a bit about financial statements, let us see how they are used to help owners, managers, investors, and creditors assess a firm's performance and financial strength. You can glean a wealth of information from financial

statements, but first you need to learn a few basic principles for “unlocking” it.

## Trend Analysis from the Income Statement

Figure 6. Apple Inc. Income Statement

Apple Inc.			
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS (Unaudited)			
(In millions, except number of shares which are reflected in thousands and per share amounts)			
	Three Months Ended		
	December 30, 2017	December 31, 2016	
Net sales	\$ 88,293	\$ 78,351	
Cost of sales <sup>(1)</sup>	54,381	48,175	
Gross margin	33,912	30,176	
Operating expenses:			
Research and development <sup>(1)</sup>	3,407	2,871	
Selling, general and administrative <sup>(1)</sup>	4,231	3,946	
Total operating expenses	7,638	6,817	
Operating income	26,274	23,359	
Other income/(expense), net	756	821	
Income before provision for income taxes	27,030	24,180	
Provision for income taxes	6,965	6,289	
Net income	\$ 20,065	\$ 17,891	
Earnings per share:			
Basic	\$ 3.92	\$ 3.38	
Diluted	\$ 3.89	\$ 3.36	
Shares used in computing earnings per share:			
Basic	5,112,877	5,298,661	
Diluted	5,157,787	5,327,995	
Cash dividends declared per share	\$ 0.63	\$ 0.57	
<sup>(1)</sup> Includes share-based compensation expense as follows:			
Cost of sales	\$ 252	\$ 229	
Research and development	\$ 646	\$ 589	
Selling, general and administrative	\$ 398	\$ 438	

Peruse an abbreviated financial statement for Apple for 2017 taken directly from their website. You note that instead of showing only the current year’s results, the company has shown data for the prior year as well.

From this relatively simple exhibit, considerable information about Apple’s performance. For example:

Apple sales grew at 12.7% from 2016 to 2017, not bad for a company with such a large base of sales already, but certainly not the rapid-growth company it once was. When making yearly comparisons this is commonly referred to as performing a horizontal analysis.

Net income as a percent of sales (a ratio also known as return on sales) was 22.7% in 2017, or for every \$5 in sales, Apple turned more than \$1 of it into profit. That is substantial! When calculating ratios as a percent of a larger figure (i.e., Net income as a percent of sales, or cash as a percent of Total Assets) this is commonly referred to as performing a vertical analysis.

Many other calculations are possible from Apple's data, and we will look at a few more than we explore ratio analysis.

## Ratio Analysis

How do you compare Apple's financial results with those of other companies in your industry or with the other companies whose stock is available to investors? And what about your balance sheet? Are there relationships on this statement that also warrant investigation? These issues can be explored by using ratio analysis, a technique for evaluating a company's financial performance.

Remember that a ratio is just one number divided by another, so expressing the relationship between the two numbers. It is hard to learn much from just one ratio, or even several ratios covering the same period. Rather, the deeper value in ratio analysis lies in looking at the trend of ratios over time and in comparing the ratios for several time periods with those of other companies. There are several ways to categorize financial ratios.



SOURCE: [Stevepb.](#)

Figure 7. Apple Inc. Consolidated Balance Sheets

Apple Inc.

**CONDENSED CONSOLIDATED BALANCE SHEETS (Unaudited)**  
(In millions, except number of shares which are reflected in thousands and par value)

	December 30, 2017	September 30, 2017
<b>ASSETS:</b>		
Current assets:		
Cash and cash equivalents	\$ 27,491	\$ 20,289
Short-term marketable securities	49,662	53,892
Accounts receivable, less allowances of \$59 and \$58, respectively	23,440	17,874
Inventories	4,421	4,855
Vendor non-trade receivables	27,459	17,799
Other current assets	11,337	13,936
Total current assets	143,810	128,645
Long-term marketable securities	207,944	194,714
Property, plant and equipment, net	33,679	33,783
Goodwill	5,889	5,717
Acquired intangible assets, net	2,149	2,298
Other non-current assets	13,323	10,162
Total assets	\$ 406,794	\$ 375,319
<b>LIABILITIES AND SHAREHOLDERS' EQUITY:</b>		
Current liabilities:		
Accounts payable	\$ 62,985	\$ 49,049
Accrued expenses	26,281	25,744
Deferred revenue	8,044	7,548
Commercial paper	11,980	11,977
Current portion of long-term debt	6,498	6,496
Total current liabilities	115,788	100,814
Deferred revenue, non-current	3,131	2,836
Long-term debt	103,922	97,207
Other non-current liabilities	43,754	40,415
Total liabilities	266,595	241,272
Commitments and contingencies		
Shareholders' equity:		
Common stock and additional paid-in capital, \$0.00001 par value: 12,600,000 shares authorized; 5,081,651 and 5,126,201 shares issued and outstanding, respectively	36,447	35,867
Retained earnings	104,593	98,330
Accumulated other comprehensive income/(loss)	(841)	(150)
Total shareholders' equity	140,199	134,047
Total liabilities and shareholders' equity	\$ 406,794	\$ 375,319

Here is one set of categories:

Profitability ratios tell you how much profit is made relative to the amount invested (return on investment) or the amount sold (return on sales).

Liquidity ratios tell you how well positioned a company is to pay its bills in the near term. Liquidity refers to how quickly an asset can be turned into cash. For example, the share of stock is substantially more liquid than a building or a machine.

Debt ratios look at how much borrowing a company has done to finance the operations of the business. The more borrowing, the more risk a company has taken on, and so the

less likely it would be for new lenders to approve loan applications.

Efficiency ratios tell you how well your assets are being managed.

We could employ many ratios but will focus on a few key examples.

## **Profitability Ratios**

Earlier we looked at the return on sales for Apple. Another profitability ratio on which the financial markets focus is earnings per share, also known as EPS. This ratio divides net income by the number of shares of stock outstanding. According to the earlier exhibit, Apple saw its EPS increase from \$3.38 in 2016 to \$3.92 in 2017, which shows a profit of about 15% an excellent return for a company that is already among the world's largest. Well-paid analysts will spend hours to understand how these results were achieved every time Apple issues new financial statements.

## **Liquidity Ratios**

Liquidity ratios are one element of measuring the financial strength of a company. They assess its ability to pay its current bills. A key liquidity ratio is called the current ratio. It simply examines the relationship between a company's current assets and its current liabilities. On December 30, 2017 (remember that balance sheets reflect a point in time), Apple had \$68.5 billion in current assets and \$63.5 billion in current liabilities. Simply, what this means is that Apple has more money on hand than they need to pay their bills. When a company has a current ratio greater than 1, they



are in good shape to pay their bills; companies selling to Apple on credit would not need to worry that it is likely to run out of money.

**Apple's current ratio = \$68.5 Billion / \$63.5 Billion = 1.08  
(greater than >) 1**

Now, let us peek at something that is not part of the ratio; look down one line on the balance sheet to long-term marketable securities and see that Apple owns \$207.9 billion. While they are long-term and so not part of the current ratio, these securities are still easily convertible to cash. Apple has far more cushion than the current ratio reflects, even though it reflected a healthy financial position already.

## Debt Ratios

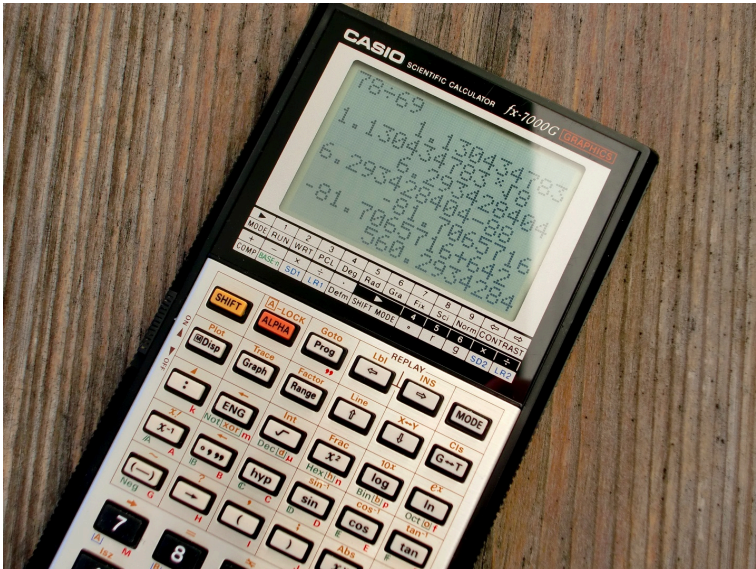
A key debt ratio, which tells us how the company is financed, is the **debt to equity ratio**, which calculates the relationship between funds gained from creditors (debt) and funds invested by owners (equity). For this ratio calculation, we use Apple's total liabilities, not just the line on the balance sheet that says long-term debt, because in effect, Apple is borrowing from those who it owes but has not yet paid. Apple's total liabilities at the end of 2017 were \$266.6 billion versus owner's equity of \$140.2 billion, a ratio of 1.9, which means Apple has borrowed more than it has invested in the business.

**Apple's debt to equity ratio: \$266.6 / \$140.2 Billion = 1.9**

To some investors, that high-level of debt might seem alarming. But remember that Apple has \$207.9 billion invested in marketable securities. If it wished to do so, Apple could sell some of those securities and pay down its debts, thus improving its ratio. It is likely that anyone thinking about lending money to Apple and seeing these figures would be confident that Apple can pay back what they borrow.

## Efficiency and Effectiveness Ratios

There are many more ratios which we could apply to Apple to understand its performance more completely. Yet going deeper into ratios would be beyond an introductory business course. If you continue your study of business, you will get ample exposure to these ratios in your accounting and finance courses.



SOURCE: [Pixabay](#).

## Key Takeaways

Accounting is measuring and summarizing business activities, interpreting financial information, and

communicating the results to management and other decision makers.

Managerial accounting deals with information produced for internal users, while financial accounting deals with external reporting.

The income statement captures sales and expenses and shows how much a firm made or lost in that period.

The balance sheet reflects the financial position of a firm at a point in time, including its assets, liabilities, and owner's equity.

- It is based on the following equation:  $\text{assets} - \text{liabilities} = \text{owner's equity}$ .

Break-even analysis is a technique used to determine the level of sales needed to break-even to operate at a sales level at which you have neither profit nor loss.

Ratio analysis is used to assess a company's performance and financial condition over time and to compare one company to similar companies or to an overall industry.

Categories of ratios include profitability ratios, liquidity ratios, debt ratios, and efficiency and effectiveness ratios.

## Footnotes

[208](https://finance.yahoo.com/q?s=aapl&fr=uh3_finance_web&uhb=uhb2) Apple Inc. (AAPL) (2018). Yahoo Finance. Retrieved from: [https://finance.yahoo.com/q?s=aapl&fr=uh3\\_finance\\_web&uhb=uhb2](https://finance.yahoo.com/q?s=aapl&fr=uh3_finance_web&uhb=uhb2),

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# 15/ Ethics and Social Responsibility

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SOURCE: [Pascualamaia](#).

## *Learning Objectives*

- Define business ethics and explain what it

means to act ethically in business.

- Identify ethical issues that you might face in business and explain rationalizations for unethical behaviour.
- Identify steps you can take to maintain your honesty and integrity in a business environment.
- Define corporate social responsibility and explain how organizations are responsible to their stakeholders, including owners, employees, customers, and the community.
- Discuss how you can identify an ethical organization, and how organizations can prevent behaviour like sexual harassment.
- Recognize how to avoid an ethical lapse, and why you should not rationalize when deciding.

## Show What You Know



An interactive or media element has been excluded from this version of the text. You can view it online here: [Link](#).

## Canada's Leader: Passing or Failing the "Smell Test"?

Ethics is not always black and white; the ethical decision is not always obvious to all. Even leaders cannot act ethically all the time. Recent decisions impacted two leaders.

Video 1. Rick's Rant – Trudeau and the Aga Khan



*A YouTube element has been excluded from this version of the text. You can view it online here:*

<https://pressbooks.library.upei.ca/startup/?p=636>

### [\(Video Link\)](#)

CBC News's reporter, E. Thompson, filed the following story on December 21, 2017. It provides a detailed account of the ethical issues surrounding Prime Minister Trudeau's trip to Aga Khan's private island. Aga Khan could face lobbying probe for Trudeau trip [Democracy Watch](#) files complaint, saying Bahamas vacation violated lobbying law.

The Aga Khan could face an investigation into allegations he violated Canada's Lobbying Act by giving Prime Minister Justin Trudeau and his family free vacations on his private island in the Bahamas at the same time as he was discussing funding for projects.

Democracy Watch sent a letter to the Commissioner of Lobbying late Wednesday, urging her to investigate whether Prince Shah Karim Al Hussaini Aga Khan IV "violated the

Lobbyists Code by giving Prime Minister Trudeau and Liberal MP Seamus O'Regan the gifts of trips to his island home”.

In the letter, Democracy Watch cofounder Duff Conacher says the Aga Khan's actions have put Trudeau and O'Regan in a conflict of interest. It is also against the law to give a public office holder a gift that could create a sense of obligation.

*“Your position must be that anyone working for or associated with a company that is registered to lobby a public office holder who gives to or does anything for that office holder... that is more than an average voter does... puts that office holder in an apparent conflict of interest.”*

- Duff Conacher

The Aga Khan is the spiritual leader of millions of Ismaili Muslims and is listed as a member of the board of directors of the Aga Khan Foundation Canada. The foundation, which has received millions of dollars in federal government development aid over the years, is registered to lobby several federal government departments including the Prime Minister's Office, although Aga Khan is not listed among those registered to lobby on its behalf.

A search of the lobbyist registry shows the foundation has filed 132 reports since 2011 outlining its meetings with government decision makers. However, no reports list any meetings with Trudeau. Representatives of the Aga Khan Foundation of Canada contacted by CBC News have yet to comment. The call for a lobbying investigation comes in the wake of a scathing report by Ethics Commissioner Mary Dawson on Wednesday.

Dawson found Trudeau violated four sections of the Conflict of Interest Act when he accepted a vacation on the



island in the Bahamas and a ride in the Aga Khan's personal helicopter.

While Trudeau and his family got a tropical vacation, Canadian taxpayers got a bill for more than \$215,000 in transportation and staffing costs, far more than the government initially disclosed to Parliament.

Dawson also revealed that Trudeau's trip during last year's Christmas holidays was one of three that Trudeau or members of his family had made to the island. Dawson disclosed that Sophie Grégoire-Trudeau stayed on the island in March 2016 with a friend and their children.

Neither the Aga Khan, nor any member of his family, was on the island during their stay. Dawson said the Aga Khan was on the island during the Trudeaus' Christmas visit last year as was a "senior American official of a previous administration," who she did not name. In her report, Dawson describes the relationship between Trudeau and the Aga Khan, the times they met and the questions they discussed.

Among them was a bilateral meeting on May 17, 2016 that was arranged by "representatives" of the Aga Khan. After a 15-minute chat between the two men about "personal matters, the Ismaili community in general and geopolitics," they were joined by three of the Aga Khan's representatives, Heritage Minister Mélanie Joly, staff members from the Prime Minister's Office and senior officials of the Privy Council Office.

Dawson's report says the government had found a funding mechanism to allow it to contribute to the Global Centre for Pluralism's endowment fund and Trudeau reaffirmed the government's \$15 million commitment during the meeting. The Aga Khan's pitch for government funding for a \$200 million riverfront renewal plan in Ottawa was also discussed.

Dawson ruled that Trudeau should have recused himself from two discussions in May 2016 involving the \$15 million grant.

*“Two months prior to the May 2016 occasions, Mr. Trudeau’s family accepted a gift from the Aga Khan that might reasonably be seen to have been given to influence Mr. Trudeau in the exercise of an official power, duty or function as Prime Minister. For this reason, the discussions with the Privy Council Office and later with the Aga Khan about the outstanding \$15 million grant to the endowment fund provided an opportunity to improperly further the private interests of the Global Centre for Pluralism.”*

- Mary Dawson, Ethics Commissioner

While the Aga Khan is not paid to lobby government (one criterion under the law) Conacher said he believes the Aga Khan violated the lobbying rules. Otherwise, it would create a giant loophole, he said.

*“Every single corporation, business, union, non-profit organization would start using board members to give gifts to politicians if this loophole were opened up by the lobbying commissioner.”*

Conacher is also calling for outgoing lobbying commissioner Karen Shepherd and incoming lobbying commissioner Nancy Bélanger to recuse themselves from ruling on the investigation because of the way Shepherd’s contract was renewed and the way Bélanger was chosen in “a secretive, PMO-controlled process.”

Manon Dion, spokeswoman for the lobbying commissioner’s office, said she cannot reveal whether they are already looking into the issue.<sup>211</sup>

## Point to Ponder



Could the Prime Minister and family have taken an ethical version of this vacation? If yes, how? If not, why not?

**The Prime  
Minister's  
Response**

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## Moving Ethics to the Business World

Perhaps you have heard of Bernie Madoff, founder of Bernard L. Madoff Investment Securities and former chairman of the NASDAQ stock exchange.<sup>214</sup> Madoff is alleged to have run a giant Ponzi scheme<sup>215</sup> that cheated investors of up to \$65 billion. His wrongdoings won him a spot at the top of Time Magazine's Top 10 Crooked CEOs. According to the SEC charges, Madoff convinced investors to give him enormous sums of money. In return, he gave them an impressive 8% to 12% return a year. But Madoff never really invested their money. Instead, he kept it for himself. He got funds to pay the first investors their return (or their money back if they asked for it) by bringing in new investors. Everything was going smoothly until the fall of 2008, when the stock market plummeted and many of his investors asked for their money. As he no longer had it, the game was over and he had to admit that the whole thing was just one big lie. Thousands of investors, including many of his wealthy friends, not-so-rich retirees who trusted him with their life savings, and charitable foundations, were financially ruined. Those harmed by Madoff were likely pleased when he was sentenced to jail for 150 years.



["Bernard Madoff, painted portrait \\_DDC5185"](#) by [Abode of Chaos](#) is licensed under [CC BY 2.0](#)

## What is Business Ethics?

It is in the best interest of a company to operate ethically. Trustworthy companies are better at attracting and keeping customers, talented employees, and capital. Those tainted by questionable ethics suffer from dwindling customer bases, employee turnover, and investor mistrust.

Let us address this question: What can individuals, organizations, and government agencies do to foster an environment of ethical behaviour in business? First, of course, we need to define the term.

## What Is Ethics?

You probably already know what it means to be ethical:

to know right from wrong and to know when you are practising one instead of the other. Business ethics is the application of ethical behaviour in a business context. Acting ethically in business means more than simply obeying applicable laws and regulations. It also means being honest, doing no harm to others, competing fairly, and declining to put your own interests above those of your company, its owners, and its workers. In business, you need a strong sense of right and wrong. You need the conviction to do what is right, even if it means doing something that is difficult or personally disadvantageous.

## Why Study Ethics?

Ideally, prison terms, heavy fines, and civil suits would discourage corporate misconduct, but, unfortunately, many experts suspect this assumption is optimistic. Whatever the condition of the ethical environment soon, one thing seems clear: the next generation entering business (which includes most of you) will find a world much different from the one that waited for the previous generation. Recent history tells us in no uncertain terms that today's business students, many of whom are tomorrow's business leaders, need a much sharper understanding of the difference between what is and is not ethically acceptable. As a business student, one of your key tasks is learning how to recognize and deal with the ethical challenges that will confront you. Asked what he looked for in a new hire, Warren Buffett, the world's most successful investor looks for three things, personal integrity, intelligence, and a high energy level, but admits without integrity the others are irrelevant.<sup>216</sup>

## Identifying Ethical Issues and Dilemmas

Ethical issues are the difficult social questions that involve some level of controversy over what is the right thing to do. Environmental protection is an example of a commonly discussed ethical issue, because there can be trade-offs between environmental and economic factors.

## Tips to maintain honesty and integrity

Follow your own code of personal conduct; act according to your own convictions rather than doing what is convenient (or profitable).

While at work, focus on your job, not on non-work-related activities, such as emails and personal phone calls.

Do not appropriate office supplies or products or other company resources for your own use.

Be honest with customer, management, coworkers, competitors, and the public.

Remember that it is the small seemingly trivial, day-to-day activities and gestures that build your character.



SOURCE: [Ekaterina](#).

When you enter the business world, you will find yourself in situations in which you will have to choose the behaviour. How would you answer the following questions?

Is it OK to accept a pair of sports tickets from a supplier?

Can I buy office supplies from my brother-in-law?

Is it appropriate to donate company funds to a local charity?

If I find out that a friend is about to be fired, can I warn her?

Obviously, the situations are many and varied. Fortunately, we can break them down into a few basic categories: issues of honesty and integrity, conflicts of interest and loyalty, bribes versus gifts, and whistleblowing. Let us look a little more closely at each of these categories.

## Issues of Honesty and Integrity

Master investor Warren Buffett once told a group of business students:

*"I cannot tell you that honesty is the best policy.*

*I cannot tell you that if you behave with*



*perfect honesty and integrity somebody somewhere won't behave the other way and make more money. But honesty is a good policy. You'll do fine, you'll sleep well at night and you'll feel good about the example you are setting for your coworkers and the other people who care about you."*<sup>217</sup>

If you work for a company that settles for its employees' merely obeying the law and following a few internal regulations, you might think about moving on. If you are being asked to deceive customers about the quality or value of your product, you're in an ethically unhealthy environment.

Think about this story:

*"A chef put two frogs in a pot of warm soup water. The first frog smelled the onions, recognized the danger, and immediately jumped out. The second frog hesitated: The water felt good, and he decided to stay and relax for a minute. After all, he could always jump out when things got too hot (so to speak). As the water got hotter, however, the frog adapted to it, hardly noticing the change. Before long, of course, he was the main ingredient in frog-leg soup."*<sup>218</sup>

What is the moral of the story? Do not sit around in an ethically toxic environment and lose your integrity a little at a time; get out before the water gets too hot and your options have evaporated.

## Conflicts of Interest

Conflicts of interest occur when individuals must choose between taking actions that promote their personal interests over the interests of others or taking actions that do not. A conflict can exist, for example, when an employee's own interests interfere with, or have the potential to interfere with, the best interests of the company's stakeholders (management, customers, and owners). Let us say that you work for a company with a contract to cater events at your college and that your uncle owns a local bakery. Obviously, this situation could create a conflict of interest (or at least give the appearance of one, which is a problem). When you are called on to furnish desserts for a luncheon, you might be tempted to send some business your uncle's way even if it is not in the best interest of your employer. What should you do? You should disclose the connection to your boss, who can then arrange things so that your personal interests do not conflict with the company's.

The same principle holds that an employee should not use private information about an employer for personal financial benefit. Say that you learn from a coworker at your pharmaceutical company that one of its most profitable drugs will be pulled off the market because of dangerous side effects. The recall will severely hurt the company's financial performance and cause its stock price to plummet. Before the news becomes public, you sell all the stock you own in the company. What you have done is called insider trading, acting on information that is not available to the public, either by trading on it or providing it to others who trade on it. Insider trading is illegal, and you could go to jail for it.

## Conflicts of Loyalty

You may one day find yourself in a bind between being loyal either to your employer or to a friend or family member. Perhaps you just learned that a coworker, a friend of yours, is about to be downsized out of his job. You also know that he and his wife are getting ready to make a deposit on a house near the company headquarters. From a work standpoint, you know you should not divulge the information. From a friendship standpoint, though, you feel it is your duty to tell your friend. Wouldn't he tell you if the situation were reversed? What do you do? As tempting as it is to be loyal to your friend, you should not tell. As an employee, your primary responsibility is to your employer. You might soften your dilemma by convincing a manager with the authority to tell your friend the bad news before he puts down his deposit.

## Bribes Versus Gifts

It is not uncommon in business to give and receive small gifts of appreciation, but when is a gift unacceptable? When is it really a bribe?

There is often a fine line between a gift and a bribe. The following information may help in drawing it, because it raises key issues in determining how a gesture should be interpreted: the cost of the item, the timing of the gift, the type of gift, and the connection between the giver and the receiver. If you are on the receiving end, it's a good idea to refuse any item that's overly generous or given to influence a decision. Because accepting even small gifts may violate company rules, always check on company policy.



Read through Bell Canada's *Code of Business*

*Conduct* detailing its recommendations for gifts. If you cannot access the image below, find it on [page 10 of the document](#).



SOURCE: [Anthony Shkraba](#).

Figure 1. Sample of Bell Canada's Code of Business Conduct

## Code of Business Conduct

### 2.3 Loans, Gifts and Entertainment

#### 2.3.1 Loans From Bell

We **do not** accept, whether directly or indirectly, any loan or guarantee of obligations from Bell that are for our personal benefit.

#### 2.3.2 Business Gifts & Entertainment

**Do not** solicit, accept or give gifts, gratuities, favours or unusual hospitality from or to suppliers or customers, which may compromise - or appear to compromise - our ability to make fair, objective, business decisions or may unfairly influence a business interaction.

**Do not** solicit or encourage gifts, hospitality, entertainment or any other thing for personal use.

**Do not** accept gifts having a monetary value, for example, gift certificates, cash, services, discounts or loans.

**These guidelines do not change during traditional gift giving season.**

We recognize, however, that building relationships with customers and suppliers is an integral part of doing business.

**You may** offer and accept reasonable hospitality in certain cases. You should consult your manager or contact the Business Conduct Help Line when in doubt about the appropriateness of a particular situation.

**You may** participate in unsolicited business entertainment depending on the function or services you perform for Bell and if the entertainment is clearly intended to facilitate business goals. If for example, tickets to a sporting or cultural event are offered, then the person offering the tickets should plan to attend the event as well.

**You may** sponsor events/activities for customers or potential customers where the purpose is to strengthen business relationships, however it is your responsibility to know and be sensitive to the customer's own code of conduct on these issues. Solicitation of modest gifts or prizes for Bell sponsored events which provide clear benefits to the sponsor and/or charitable organization is permitted upon approval by your manager.

**You may** accept unsolicited, nominal value hospitality, gifts or mementos that are customary or business related.

**You may** accept business entertainment in the form of meals as long as it is modest, infrequent, and as far as possible on a reciprocal basis.

Factors which you and your manager should consider when assessing the proper course of action include:

- Is Bell potentially involved in a major procurement activity with the company offering the gift or entertainment?
- Would the gift or entertainment be considered appropriate or customary, taking into account the nature of the function or services you perform for Bell?
- Would it be perceived as insulting or damaging to the business relationship to return the gift or decline the hospitality?
- Can the gift or hospitality be applied to benefit all team members rather than certain individuals?

SOURCE: Bell (2017).

## Whistleblowing

Whistleblowing was defined in 1972 by Ralph Nader as  
*“an act of a man or a woman who, believing in the public interest overrides the interest of the organization he serves, publicly blows the whistle*

*if the organization is involved in corrupt, illegal, fraudulent or harmful activity.”*

While there are increasing incentives from governments and regulators for whistleblowers to go public about corporate misconduct, protections for whistleblowers are still very limited. Few Canadian laws pertain directly to whistleblowing and therefore whistleblowers are mostly unprotected by statute.

There is a patchwork of protection provisions under the *Canadian Criminal Code*, *Public Servants Disclosure Protection Act (PSDPA)*, the *Public Service of Ontario Act, 2006* as well as the *Securities Act*. [Section 425.1](#) of the *Criminal Code*, states that employers may not threaten or take disciplinary action against, demote or end an employee in order to deter her/him from reporting information regarding an offence s/he believes has or is being committed by her/his employer to the relevant law enforcement authorities.

An employer cannot threaten an employee with negative repercussions to deter them from contacting law enforcement with information about the employer's offence. Punishment for employers who make such threats or reprisals can include up to five years imprisonment and/or fines.

In early 2018, a Canadian whistleblower received worldwide recognition for disclosing the amount and kinds of data harvested by Cambridge Analytica through personal Facebook accounts. However, there are other, [prominent Canadian whistleblowers](#).

## Corporate Social Responsibility

Corporate social responsibility (CSR) refers to the approach that an organization takes in balancing its responsibilities toward different stakeholders when making legal, economical, ethical, and social decisions. Remember that

we previously define stakeholders as those with a legitimate interest in the success or failure of the business and the policies it adopts. The term social responsibility refers to the approach that an organization takes in balancing its responsibilities toward their various stakeholders.

What motivates companies to be “socially responsible”? We hope it’s because they want to do the right thing, and for many companies, “doing the right thing” is a key motivator. The fact is, it is often hard to figure out what the “right thing” is: what’s “right” for one group of stakeholders isn’t necessarily “right” for another. One thing, however, is certain: companies today are held to higher standards than ever before. Consumers and other groups consider not only the quality and price of a company’s products but also its character. If too many groups see a company as a poor corporate citizen, it will have a harder time attracting qualified employees, finding investors, and selling its products. Good corporate citizens are more successful in all these areas.



[Included in this chapter is an optional open access article](#) updating Carroll’s Pyramid by Carroll himself and diving deeper into CSR.<sup>219</sup>

## Another Lens

Carroll’s Pyramid is a well-respected resource for situating corporate social responsibility. Another view of corporate social responsibility is from the perspective of a company’s relationships with its stakeholders. In this model, the focus is on managers (not owners) as the principals involved in these relationships. Owners are the stakeholders who invest risk capital in the firm in expectation of a financial return. Other stakeholders include employees, suppliers, and the communities in which the firm does business.

Figure 2. Management's Relationship with Stakeholders



Proponents of this model hold that customers, who provide the firm with revenue, have a special claim on managers' attention. The arrows show the two-way nature of corporation-stakeholder relationships. All stakeholders have some claim on the firm's resources and returns, and management's job is to make decisions that balance these claims.<sup>220</sup>

Let us look at how companies can be "socially responsible" in considering the claims of various stakeholders.



## Owners

Owners invest money in companies. In return, the people who run a company have a responsibility to increase the value of owners' investments through profitable operations. Managers also have a responsibility to provide owners (as well as other stakeholders having financial interests, such as creditors and suppliers) with accurate, reliable information about performing the business. Clearly, this is one area in which WorldCom managers fell. Upper-level management purposely deceived shareholders by presenting them with fraudulent financial statements.

## Managers

Managers have a ***fiduciary responsibility*** to owners, they safeguard the company's assets and handling its funds in a trustworthy manner. Yet managers experience what is called the agency problem; a situation in which their best interests do not align with those of the owners who employ them. To enforce managers' fiduciary responsibilities for a firm's financial statements and accounting records, Ontario's Keeping the Promise for a Strong Economy Act (Budget Measures) 2002, also known as Bill 198, (Canadian equivalent to Sarbanes-Oxley Act of 2002 in the United States) requires CEOs and CFOs to attest to their accuracy. The law also imposes penalties on corporate officers, auditors, board members, and any others who commit fraud. You will learn more about this law in your accounting and business law courses.

## Employees

Companies provide employees with safe, healthy places to work, as well as environments that are free from sexual harassment and all types of discrimination. They should also offer appropriate wages and benefits. In the following sections, we will inspect these areas of corporate responsibility.

### Wages and Benefits

At the very least, employers must obey laws governing minimum wage and overtime pay. A minimum wage is set by the provincial government. As of January 1, 2018, the Ontario rate is \$14.00 with another increase to \$15.00 set for January 1, 2019. By law, employers must also provide certain benefits, Canadian Pension Plan (CPP retirement funds), unemployment insurance (protects against loss of income in case of job loss), and depending on the industry, workers' compensation (covers lost wages and medical costs in case of on-the-job injury). Most large companies pay most of their workers more than minimum wage and offer broader benefits, including medical, dental, and vision care, as well as savings programs, to compete for talent.

### Safety and Health

Though companies should guard workers' safety and health, some simply do not. For over four decades, for example, executives at Johns Manville suppressed evidence that one of its products, asbestos, was responsible for the deadly lung disease developed by many of its workers.<sup>221</sup> The company concealed chest X-rays from stricken workers, and executives

decided it was simply cheaper to pay workers' compensation claims than to create a safer work environment. A New Jersey court was quite blunt in its judgement: Johns Manville, it held, had made a deliberate, cold-blooded decision to do nothing to protect at risk workers, in blatant disregard of their rights.<sup>222</sup>

Currently, responsibility for workers' compensation and occupational health and safety issues falls largely to provinces or territories, and each jurisdiction has different approaches in capturing data. As a result, there is an "uneven landscape" of health and safety research capacity, said Barbara Neis, cofounder and senior research associate at the SafetyNet Centre for Occupational Health and Safety Research at Memorial University. The last time Statistics Canada produced a national analysis was in 1996.

Responsibility for fatality and injury counts, which are based on accepted workers' compensation claims, shifted over to the Association of Workers' Compensation Boards. Detailed data must be purchased, and researchers say these counts do not represent the entire workforce, partly because not all sectors or types of workers are included in the workers' compensation system.

Workers' compensation numbers show about 350 Canadians die each year from an on-the-job injury at work. If longer-term work-related illnesses (such as mesothelioma from asbestos exposures, or lung cancers from silica dust) are factored in, this number climbs to about 1,000 deaths a year.



An interactive or media element has been excluded from this version of the text. You can view it online here: [Link](#).

## Customers

The purpose of any business is to satisfy customers, who reward businesses by buying their products. Sellers are

also responsible (both ethically and legally) for treating customers fairly. This means customers have:

The right to safe products. A company should sell no product that it suspects of being unsafe for buyers. Thus, producers have an obligation to safety-test products before releasing them for public consumption. The automobile industry, for example, conducts extensive safety testing before introducing new models (though recalls remain common).

The right to be informed about a product. Sellers should furnish consumers with the product information that they need to make an informed purchase decision. That is why pillows have labels identifying the materials used to make them.

The right to choose what to buy. Consumers have a right to decide which products to purchase, and sellers should let them know what their options are. Pharmacists, for example, should tell patients when a prescription can be filled with a cheaper brand name or generic drug. Telephone companies should explain alternative calling plans.

The right to be heard. Companies must tell customers how to contact them with complaints or concerns. They should also listen and respond.

Companies share the responsibility for the legal and ethical treatment of consumers with several government agencies.

From the federal Office of Consumer Affairs (<https://www.ic.gc.ca>):

*In Canada, consumer complaints are regulated by different levels of government, as well as non-government organizations. Finding the right place to direct your complaint is not always easy but understanding your rights as a consumer is an important part of the complaint filing process.*

## Provincial and territorial consumer protection legislation

Many consumer complaints fall under provincial and territorial jurisdiction, including issues related to:

- Buying goods and services.
- Contracts.
- Purchase, maintenance, or repair of motor vehicles.
- Credit reporting agencies and the practices of collection agencies.

## Federal consumer protection legislation

The Government of Canada has an important role in consumer awareness and protection. Federal agencies and departments enforce legislation related to various issues, including:

- Consumer product safety.
- Food safety.
- Consumer product packaging and labelling.
- Anti-competitive practices (i.e. price fixing, misleading advertising).
- Privacy complaints.

## Additional resources to remember



Follow or bookmark this link for some of the more relevant areas where federal agencies and departments regulate consumer issues: <https://www.ic.gc.ca/eic/site/oca-bc.nsf/eng/ca02965.html>

In Ontario, customers have the added protection of the [\*Consumer Protection Act\*](#).



An interactive or media element has been excluded from this version of the text. You can view it online here: [Link](#).



SOURCE: [Pixabay](#).

## Communities

For obvious reasons, most communities see getting a new business as an asset and view losing one (especially a large employer) as a detriment. After all, the economic impact of business activities on local communities is substantial: they provide jobs, pay taxes, and support local education, health, and recreation programs. Both big and small businesses donate funds to community projects, encourage employees to volunteer their time, and donate equipment and products for a variety of activities. Larger companies can make greater financial contributions. Let us start by taking a quick look at the philanthropic activities of a few U.S. corporations.

# Philanthropy

Many large corporations support various charities, an activity called philanthropy. Some donate a percentage of sales or profits to worthwhile causes. Retailer Target, for example, donates 5% of its profits (about \$2 million per week) to schools, neighbourhoods, and local projects across the country; its store-based grants underwrite programs in early childhood education, the arts, and family-violence prevention.<sup>223</sup> The late actor Paul Newman donated 100% of the profits from “Newman’s Own” foods (salad dressing, pasta sauce, popcorn, and other products sold in eight countries). His company continues his legacy of donating all profits and distributing them to thousands of organizations, including the Hole in the Wall Gang camps for seriously ill children.<sup>224</sup>

Across the border, Canadian companies also show their philanthropic side. Tim Horton’s Children’s Foundation sends 19,000 kids to camp each summer, who would otherwise not have the resources to attend.<sup>225</sup> Its Timbits Minor Sports Program supports the participation of 300 000 kids in their pursuit of hockey, soccer, lacrosse, softball, baseball, and ringette.<sup>226</sup> In 2017, Loblaw Companies and its President’s Choice Children’s Charity pledged \$150 million over the next decade to address childhood hunger in Canada.<sup>227</sup> These are just two examples of Canadian companies giving back at the local and national levels.

## Ethical Organizations

One goal of anyone engaged in business should be to foster ethical behaviour in the organizational environment. How do we know when an organization is behaving ethically?

Most lists of ethical organizational activities include the following criteria:

- Treating employees, customers, investors, and the public fairly

- Holding every member personally accountable for his or her action

- Communicating core values and principles to all members

- Demanding and rewarding integrity from all members in all situations<sup>228</sup>

Employees at companies that consistently make Business Ethics magazine's list of the "100 Best Corporate Citizens" regard the items on the previous list as business as usual in the workplace. Companies at the top of the 2016 list include Microsoft, Hasbro, Ecolab, Bristol-Myers-Squibb, and Lockheed Martin.<sup>229</sup>

Employees with the following attitudes tend to suspect that their employers are not as ethical as they should be:

- Consistently feel uneasy about the work they do.

- Object to the way they are treated.

- Are uncomfortable about the way coworkers are treated.

- Question the appropriateness of management directives and policies.<sup>230</sup>

## Sexual Harassment

Sexual harassment occurs when an employee makes "unwelcome sexual advances, requests for sexual favours, and other verbal or physical conduct of a sexual nature" to another employee. It is also considered sexual harassment when "submission to or rejection of this conduct explicitly or implicitly affects an individual's employment, unreasonably interferes with an individual's work performance or creates an intimidating, hostile or offensive work environment."<sup>231</sup>



Sexual harassment rocketed to the top of news reports and social media when on October 5, 2017, *The New York Times* broke the story of Harvey Weinstein's decades of harassment in Hollywood. In March 2018, [CBC News collated the allegations of sexual harassment against prominent Canadians](#). The list, including only those allegations reported by CBC, highlight the prevalence of this issue.

To prevent sexual harassment (or at least minimize its likelihood) a company should adopt a formal anti-harassment policy describing prohibited conduct, asserting its objections to the behaviour, and detailing penalties for violating the policy. Employers also have an obligation to investigate harassment complaints. Failure to enforce anti-harassment policies can be very costly. At the end of 2017, 353 women had submitted and completed sexual harassment, discrimination or intimidation claims against the RCMP with as many as another 650 expected to file. To settle these claims, the government of Canada has set aside \$100 million.

## Workforce Diversity | Inclusive Workplaces

Besides complying with equal employment opportunity laws, many companies make special efforts to recruit employees who are underrepresented in the workforce according to sex, race, or some other characteristic. In helping to build more inclusive workforces, such initiatives contribute to competitive advantage for two reasons:

People from diverse backgrounds bring new talents and fresh perspectives to an organization, typically enhancing creativity in the development of new products.

By more accurately reflecting the demographics of the marketplace, a diverse workforce improves a company's ability to serve an ethnically diverse population.

Each year [The Globe and Mail, reports on Canada's Top](#)

[100 Employers](#). Peruse the list of industry winners and follow through to highlights detailing why the company topped the list.

Please note the selection process:

To determine this year's winners of the *Canada's Best Diversity Employers* competition, Mediagroup editors reviewed diversity and inclusiveness initiatives at employers that applied for the Canada's Top 100 Employers project. From this applicant pool, a smaller short-list of employers with noteworthy and unique diversity initiatives was developed. The short-listed candidates' programs were compared to those of other employers in the same field. The finalists chosen to represent the diversity leaders in their industry and region of Canada.



SOURCE: [Matheus Bertelli](#).

## The Individual Approach to Ethics

How can you make sure that you do the right thing in the business world? How should you respond to the kinds of challenges that you'll be facing? Because your actions in

the business world will be strongly influenced by your moral character, let us begin by assessing your current moral condition. Which of the following best applies to you (select one)?

Always ethical.

Mostly ethical.

Somewhat ethical.

Seldom ethical.

Never ethical.

Now that you have placed yourself in one of these categories, here are some general observations. Few people put themselves below the second category. Most of us are ethical most of the time, and most people assign themselves to category number two, "I'm mostly ethical." Why don't more people claim they are always ethical?

Apparently, most people realize that being ethical all the time takes a great deal of moral energy. If you placed yourself in category number two, ask yourself this question: How can I change my behaviour so that I can move up a notch? The answer to this question may be simple. Just ask yourself an easier question: How would I like to be treated in each situation?<sup>232</sup>

Unfortunately, practising this philosophy might be easier in your personal life than in the business world. Ethical challenges arise in business because companies, especially large ones, have multiple stakeholders who sometimes make competing demands. Making decisions that affect multiple stakeholders is difficult even for seasoned managers; and for new entrants to the business world, the task can be extremely daunting. You can, however, get a head start in learning how to make ethical decisions by looking at two types of challenges that you will encounter in the business world: ethical dilemmas and ethical decisions.

## Addressing Ethical Dilemmas

An ethical dilemma is a morally problematic situation: you must choose between two or more acceptable but often opposing alternatives that are important to different groups. Experts often frame this type of situation as a “right-versus-right” decision. It is the sort of decision that Johnson & Johnson (known as J&J) CEO James Burke had to make in 1982.<sup>233</sup> On September 30, twelve-year-old Mary Kellerman of Chicago died after her parents gave her Extra-Strength Tylenol. That same morning, 27 year-old Adam Janus, also of Chicago, died after taking Tylenol for minor chest pain. That night, when family members came to console his parents, Adam’s brother and his wife took Tylenol from the same bottle and died within 48 hours. Over the next two weeks, four more people in Chicago died after taking Tylenol. The actual connection between Tylenol and the series of deaths wasn’t made until an off-duty firefighter realized from news reports that every victim had taken Tylenol. As consumers panicked, J&J pulled Tylenol off Chicago-area retail shelves. Researchers discovered Tylenol capsules containing large amounts of deadly cyanide. Because the poisoned bottles came from batches originating at different J&J plants, investigators determined that the tampering had occurred after the product had been shipped.<sup>234</sup>

J&J was not at fault, but CEO Burke was still faced with an extremely serious dilemma: Was it possible to respond to the tampering cases without destroying the reputation of a highly profitable brand?

Burke had two options:

He could recall only the lots of Extra-Strength Tylenol that were found to be tainted with cyanide. In 1991, Perrier executives recalled only tainted product when they discovered that cases of their bottled water had been

poisoned with benzine. This option favoured J&J financially but possibly put more people at risk.

Burke could order a nationwide recall of all bottles of Extra-Strength Tylenol. This option would reverse the priority of the stakeholders, putting the safety of the public above stakeholders' financial interests.

Burke opted to recall all 31 million bottles of Extra-Strength Tylenol on the market. The cost to J&J was \$100 million, but public reaction was quite positive. Less than six weeks after the crisis began, Tylenol capsules were reintroduced in new tamper-resistant bottles, and by responding quickly and appropriately, J&J eventually restored the Tylenol brand to its previous market position. When Burke was applauded for moral courage, he replied he would simply adhered to the long-standing J&J credo that put the interests of customers above those of other stakeholders. His only regret was that the perpetrator was never caught.<sup>[235](#)</sup>



SOURCE: [Anna Shvets](#).

If you are wondering what your thought process should be if you're confronted with an ethical dilemma, you might wish to remember the mental steps listed here, which are the steps taken to address the Tylenol crisis:

Define the problem: How to respond to the tampering case without destroying the reputation of the Tylenol brand.

Identify feasible options: (1) Recall only tainted Tylenol lots or (2) order a nationwide recall of all bottles of Extra-Strength Tylenol.

Assess the effect of each option on stakeholders: Option 1 (recalling only the tainted lots of Tylenol) is cheaper but puts more people at risk. Option 2 (recalling all bottles of Extra-Strength Tylenol) puts the safety of the public above stakeholders' financial interests.

Establish criteria for determining the most appropriate action: Adhere to the J&J credo, which puts the interests of customers above those of other stakeholders.

Select the best option based on the established criteria: In 1982, Option 2 was selected, and a nationwide recall of all bottles of Extra-Strength Tylenol was conducted.

## Making Ethical Decisions

In contrast to the “right-versus-right” problem posed by an ethical dilemma, an ethical decision entails a “right-versus-wrong” decision, one in which there is clearly a right (ethical) choice and a wrong (unethical or illegal) choice. When you decide that is unmistakably unethical or illegal, you’ve committed an ethical lapse. If you are presented with this type of choice, asking yourself the following questions and increase your odds of making an ethical decision.

Is the action illegal?

Is it unfair to some stakeholders?

If I do it, will I feel badly about it?

Will I be ashamed to tell my family friends, coworkers, or boss?

Will I be embarrassed if my action is written up in the newspaper?

## What to Do When the Light Turns Yellow

Like our five questions, some ethical problems are straightforward. Others, unfortunately, are more complicated, but it will help to think of our five-question test as a set of signals that will warn you are facing a tough decision, that you should think carefully about it and perhaps consult someone else. The situation is like approaching a traffic light. Red and green lights are easy; you know what they mean and exactly what to do. Yellow lights are trickier. Before you decide which pedal to hit, try posing our five questions. If you get a single yes, you will almost surely be better off hitting the brake.<sup>236</sup>

### *Key Takeaways*

Business ethics is the application of ethical behaviour in a business context. Ethical (trustworthy) companies are better able to attract and keep customers, talented employees, and capital.

Acting ethically in business means more than just obeying laws and regulations. It also means being honest, doing no harm to others, competing fairly, and declining to put your own interests above those of your employer and coworkers.



In the business world, you will encounter conflicts of interest: situations in which you will have to choose between taking action that promotes your personal interest and action that favours the interest of others.

Corporate social responsibility refers to the approach that an organization takes in balancing its responsibilities toward different stakeholders (owners, employees, customers, and the communities in which they conduct business) when making legal, economic, ethical, and social decisions.

Managers have several responsibilities: to increase the value of owners' investments through profitable operations, to provide owners and other stakeholders with accurate, reliable financial information, to safeguard the company's assets, and to handle its funds in a trustworthy manner.

Companies have a responsibility to pay appropriate wages and benefits, treat all workers fairly, and provide equal opportunities for all employees. In addition, they must guard workers' safety and health and to provide them with a work environment that's free from sexual harassment.

Consumers have certain legal rights: to use safe products, to be informed about products, to choose what to buy, and to be heard. Sellers must comply with these requirements.

Business people face two types of ethical challenges: ethical dilemmas and ethical decisions.

An ethical dilemma is a morally problematic

situation in which you must choose to compete and often conflicting options which do not satisfy all stakeholders.

An ethical decision is one in which there's a right (ethical) choice and a wrong (unethical or downright illegal) choice.

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- 47 Economic segment:** The portion of the general environment that involves economic and financial conditions.
- 48 Social segment:** The portion of the general environment that involves demographics and cultural trends.
- 49 Technological segment:** The portion of the general environment that involves scientific advances.
- 50 Environmental segment:** The portion of the general environment that involves the natural environment.
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68 The set of external conditions and forces that have the potential to influence the organization.

69 Industry (competitive environment): Multiple organizations that collectively compete with one another by providing similar goods, services, or both.

70

General environment (macro environment): Overall trends and events in society such as social trends, technological trends, demographics, and economic conditions.

71 **Opportunities:** Events and trends that create chances to improve an organization's performance level.

72 **Threats:** Events and trends that may undermine an

organization's performance.

**73 Economies of scale:** A cost advantage created when a firm can produce a good or service at a lower per unit price due to producing the good or service in large quantities.

**74 Strategic play:** A specific move designed to outwit or trick competitors.

**75 Strategy as pattern:** The extent to which a firm's actions over time are consistent.

**76 Strategy as position:** A firm's place in the industry relative to its competitors.

**77 Strategy as perspective:** How executives interpret the competitive landscape around them.

**78 Intellectual property:** The legal rights that result from intellectual activity in the industrial, scientific, literary, and artistic fields (Canadian Intellectual Property Office, 2014).

**79 Patent:** Legal decree that protects inventions from direct imitation for a limited period.

**80 Trademark:** A word (or words), a design, or a combination of these used to identify the goods or services of one person or organization.

**81 Copyright:** Provides exclusive rights to the creators of original artistic works such as books, movies, songs, and screenplays.

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[45](#) **PESTEL analysis:** The examination of political, economic, social, technological, environmental, and legal factors and their implications for an organization.

[46](#) **Political segment:** The portion of the general environment that involves governments.

[47](#) **Economic segment:** The portion of the general environment that involves economic and financial conditions.

[48](#) **Social segment:** The portion of the general environment that involves demographics and cultural trends.

[49](#) **Technological segment:** The portion of the general environment that involves scientific advances.

[50](#) **Environmental segment:** The portion of the general environment that involves the natural environment.

[51](#) **Legal segment:** The portion of the general environment that involves the law and courts.

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68 The set of external conditions and forces that have the potential to influence the organization.

69 Industry (competitive environment): Multiple organizations that collectively compete with one another by providing similar goods, services, or both.

70

General environment (macro environment): Overall trends and events in society such as social trends, technological trends, demographics, and economic conditions.

71 **Opportunities:** Events and trends that create chances to improve an organization's performance level.

72 **Threats:** Events and trends that may undermine an organization's performance.

73 **Economies of scale:** A cost advantage created when a firm can produce a good or service at a lower per unit price due to producing the good or service in large quantities.

74 **Strategic ploy:** A specific move designed to outwit or trick competitors.

75 **Strategy as pattern:** The extent to which a firm's actions over time are consistent.

76 **Strategy as position:** A firm's place in the industry relative to its competitors.

77 **Strategy as perspective:** How executives interpret the competitive landscape around them.

78 **Intellectual property:** The legal rights that result from intellectual activity in the industrial, scientific, literary, and artistic fields (Canadian Intellectual Property Office, 2014).

**79 Patent:** Legal decree that protects inventions from direct imitation for a limited period.

**80 Trademark:** A word (or words), a design, or a combination of these used to identify the goods or services of one person or organization.

**81 Copyright:** Provides exclusive rights to the creators of original artistic works such as books, movies, songs, and screenplays.

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