Management - First Partial

The act or skill of controlling and **making decisions** about a business. The process of organizing, planning, leading and controlling resources within an entity with the overall aim of achieving its objectives.

Chapter 1 – People, Economic Activity and Economic Theories. Session 01.

Management is a **range of decisions** associated with the acquisition, allocation and integration of resources (human, physical, financial, etc.) required to perform a certain economic activity.

"Economic activity is the **production** and the **consumption** of economic goods".

People aspire to a variety of **goals** at differing levels. The pursuit of these goals gives rise to **needs**. One way to satisfy these needs is through **economic activity**, that is, by producing and consuming economic goods.

A large proportion of economic activity takes place in **social bodies**, which are aggregation of individuals.

There are two completely different schools of economic thought which would evolve out of one or the other of the following hypothetical alternatives:

- People are **perfectly rational**, isolated individuals who are motivated purely by self-interest. (Homo Oeconomicus)
- People act as members of a group; they possess bounded rationality and can be moved by **altruistic principles**.

The needs of the people can be divided in **Natural** and **Social**, Maslow gave us a pyramid describing their relations trough a hierarchy.

Goods can be divided between **Economic goods** and **Free goods**.

Free goods are those that are not scarce.

Economics goods are those that are useful but scarce. So they require human production. The economic goods have many other inner diversification:

Primary (water)	**Non-Essential** (wine)
Complementary (car – fuel)	**Substitutes** (car – moto)
Differentiable (bags)	**Non-Differentiable** (fuel)
Consumer (B2C)	**Instrumental** (B2B)
Disposable (food) (chose as consolation during crisis)	**Durable** (car) (more affected by crisis)
Individual (bicycle)	**Collective** (cinema)
Private (High Competition, High Prices)	**Public** (Monopoly, No competition, low prices)
There exists also an **intersection between private and public**, for goods extremely important for society like Hospitals, Education and Transportation. In this sector there is High competition and Low Prices.	

The activities that are necessarily involved in the production of economic goods are:

- Technical transformation
- Transactions
- Complementary (Support Activities)

The **technical transformation** consists of *physical*, *spatial* and *logical transformation* of raw materials, systems, data or knowledge.

Production and consumption processes happen within various organizations. However, organizations are not economically isolated from one another; instead they are linked by a tightly woven network of exchanges.

The role of linking organizations to other organizations and individuals is covered by the **transactions**.
Transactions are basically classified by what is being exchanged.
The majority of transactions involve *private goods*, *financial resources*, *work*, *risk coverage* (transferring the issue to an insurance company in change of money), and *public goods*, where individuals acquire access to them by paying taxes.

The processes of transactions lead to *chains*, which are usually *supply chains*, often creating *vertical integration* that can be *downstream* or *upstream*.

To conclude the general summary of major classes of processes which make up economic activity, one should keep in mind essential

activities which are **complementary** to the technical transformations and transactions which all organizations carry out.
Such activities can be categorized as follows:

- *Institutional structure design*: founding and giving shape to the organization. (corporate governance)
- *Organization and human resource management*: organizing and managing people.
- *Accounting and information management*: keeping track of activities.

Chapter 2 – Organizations, families, and economic specialization. Session 02.

The economic activity can be carried out by both **individuals** and **organizations**. Even if the majority of it is carried out by organizations.

What allows organizations to dominate are:
- **Efficiency**, ability of producing an **organizational rent**.
- **Social needs**, organizations fulfil human needs for sociality through deep, beneficial interpersonal relationships.

The *organizational rent* is the product of intelligent cooperation among several people who are pursuing the same goal, leading to an economic advantage. This cooperation enables each worker to receive more than when selling the outcome as an individual effort. The lower cost or higher quality of outcomes compete away individual producers.

Social bodies are human groups that often take on the traits of institutions, that is, they adopt stable rules and models of behaviour.

These social bodies are normally divided into two groups: ***families*** and ***organizations*** (*Firms*, *State*, *Non-Profits*). The first ones are natural social bodies, while the second are communities whose purpose is attaining relatively specific goals, with rules of conduct that are deliberately designed and formalized.

The main purpose of **families** is *non-economic*, but satisfying the needs of family members, including economic ones. Typical economic operations: consumption, income generation, internal work, saving and investment, insurance management, paying taxes, financing and building capital.

The purpose of **firms** is *economic* (*for-profit*) mainly to produce *revenues*. They satisfy needs of core stakeholders, *employees* and *shareholders*, who are essential to the existence and governance of the firm; but also non-core stakeholders, *customers*, are also crucial. Typical economic operations: buying input, transformation, selling output.

Firms are a crucial part of society and on their own terms they take part in the attainment of the common good. There is then a social nature of the firm showing that the action undertaken by a firm is influenced by constraints arising from extra-economic finalism.

The purpose of **States** is *non-economic* (political, social, cultural). The aim of a national political community lies in the complex realization of the social and spiritual development of its citizens. They are divided in branches (central/federal, regions, provinces) and other entities. The core stakeholders are the national community and state employees. Typical economic operations: production and consumption of public goods, as well as generating rewards for employees. The state finance itself through **taxes** and **debt** (BTP).

The purpose of **Non-Profit Organizations** is *economic* (*not for profits*), including a combination of goals entailing producing rewards, producing and consuming goods by members of the organization. They may be very similar to firms in how they are managed and organized. They use a mix of volunteers and regular employees. They may sell products or services, pursue interests of members, provide public goods for free. In order to be a Non-profit organization has to be private. The primary economic goal is to satisfy the needs of certain categories of people. Depending on the type of organization, these people may be members or excludable users or the entire community.

	Families	Firms	State, public bodies	Nonprofit organizations
Fundamental purpose	Social, ethical, religious	Economic	Social and moral	Social, moral, cultural
Primary economic goals	Fulfilling family members' needs	Producing monetary and non-monetary rewards	Producing and consume public goods (and provide rewards for employees)	Fulfilling needs of members/ excludable users/ the community at large (and provide rewards for employees)
Core stakeholders	All family members (plus others in some cases)	Employees and shareholders (plus others in some cases)	All members of the political body (and employees)	Various mixes of members, donors, the State, employees
Main non-core stakeholders	Other families who are blood relations; domestic staff	Suppliers, customers, other capital providers	Suppliers, capital providers, other public bodies	Suppliers, capital providers, State, "customers"
Typical economic processes	Consumption, assets management, work, study	Transactions of goods, technical transformations, credit transactions, risk transactions	Production and consumption of public goods, tax collection	Production (or production and consumption) of goods

One of the most apparent aspects of modern economic systems is specialization. The degree of specialization in modern economic activities can be seen on three levels:

- By **macro – classes** of organizations, the fact that we have four different social bodies that carry out economic activity. **Only families** would lead to a "**self-consumption**" model, inefficient because too small to achieve adequate specialization. They have a room in the economy because they are natural social bodies.
  Only firms would lead to an "**anarcho-capitalism**" model, firms can take full advantage of specialization, adapting their size and investments to all technical opportunities.
  Only state would lead to an "**absolute hierarchy**" model, because beyond a certain size coordination costs are too high, the state is anyway efficient to solve market failures.
  Only non-profits would lead to some **utopian narratives**, non-profits are fundamental to solve state failures.

- **Within each macro-class**, while in families relatively analogous sets of economic activities occur, firms are highly specialized in the production of specific types of goods targeting specific categories of costumers, and in carrying out particular kinds of transactions.

- **Within each organization**, we find specialization within single organizations, where various organizational units and individuals perform specific tasks, tapping into special skills and resources. **Organizational charts** represent division of labour and coordination within each organization.

Why are people inclined to organize their activities by specialization? Of course, there are clear advantages inherent to specialization: **activities take place with more speed and efficiently, with less effort and with higher quality results**. These advantages, interpreted in economic terms, can be called **specialization economies**.

The sources of specialization economies are:

- **Learning Processes**, repeating the same activity leads to develop manual dexterity, discovering more efficient and effective ways to perform the activity, creating an inventory of problems and solutions.

- **Individual Skills**, specialization allows to assign tasks to those people who are most skilled at them.

- **Technical and managerial orientation**, people with a particularly focused technical and managerial orientation can be assigned specialized tasks. This would guarantee that pre-set goals are effectively pursued. Conversely, problems of integration can arise with others who have a different orientation.

- **Setting / Set – up costs**, these are the costs to shift from a task to another, Taylor introduced for the first time in Ford Motors his theory on chain and specialized operations to reduce set up costs.

- **Facilities and Equipment**, until now we have referred to the specialization of a single worker. Just as important are specialized facilities and equipment. They also combine well with specialized work, because specialized workers may be required to run them.

- **Job identification and motivation**, a high degree of labour specialization can impact individual motivation in a positive way. Very specialized people tend to identify with their job and enjoy a sense of command over their work situation. Mastery, the feeling of being irreplaceable and the quality of results contribute to satisfying the need for esteem. Specialized works can allow people to reach the **top of Marlow's pyramid**.

Specialization can also result in disadvantages. Therefore, the optimal degree of specialization can be found by striking a balance between advantages and disadvantages. The major limitations are:

- **Cost of coordination**, someone must divide and organize work, Managers' don't contribute to the production, but they are a high cost for the firms.

- **Cost of rigidity and specific investments**, varied skills and multi-purpose facilities can be easily redeployed to new tasks, while specialized resources are less flexible.

- **Demotivation**, highly repetitive tasks can reduce esteem and self-fulfilment.

Managing for Stakeholders – Opportunism, Fairness, and Cooperation - Session 03, Session 04.

Management is about people, economic activity takes place in human societies and is based on human work. So it is important to have assumptions about people:

- **Homo Oeconomicus**, **perfectly rational**, able to compare alternatives with all information available for free. Individual preferences described by **utility functions, maximization of income** and **no room for reciprocity, trust and other emotions**. This view of people is useful for formalizing economic behaviour and building economic models.

- **Human Beings**, limits on information and cognitive ability (**bounded rationality**), members of groups, which shape their preferences and behaviour, pursue of **well-being**, emotions and propensity to **cooperative behaviour**.

The theory of bounded rationality was introduced by economist **Herbert Simon**: individuals look for satisfactory solutions to their problems, given **constraints on time**, **available information and resources**. Expectations drive initial search but are adjusted according to results until a solution appears acceptable. (People tend to adjust their expectations through the process).

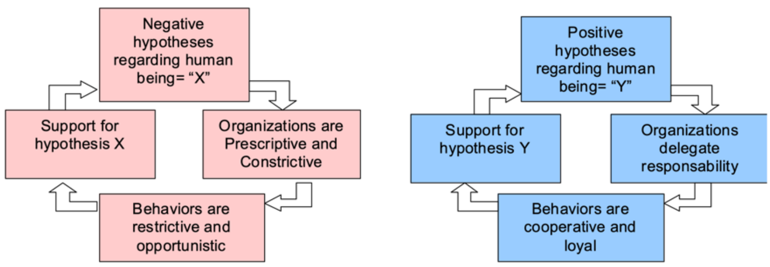
Many organizational activities are carried out in social groups, which are elementary social bodies: usually composed of a small number of members (3-7), spontaneous formation, internal social order, generation of norms, equilibrium between giving and taking, leadership. Each member has expectations of other members and of him/herself.

Organizations have clear goals, formal structures and procedures, information systems, etc.

So, one could think that organizations may come closer than individuals to **perfect rationality**. However, even group decision-making is often not rational. Sometimes even worse that individuals, example the "**Garbage Can Model**", where often the solution for the problem is not meritocratic chosen but only on an authority base.
Solutions are proposed for problems that do not exist and choices are made that do not solve the problem.

Cooperation it's useful because it's able to create **organizational rents** and **residual results** (dividends for shareholders), but it requires a certain degree of trust among participants. **Free ridership** is possible when participants can limit their efforts without losing their share of the rent, leading to a destruction of trust, cooperation and rents. Therefore it's auspicial a model where individual contributions are clear, otherwise opportunistic behaviour is possible.

Psychologist Douglas McGregor proposed that trust in groups also depends on hypotheses. These assumptions become self-fulfilling prophecies.



The Shareholder View – Milton Friedman:
Only people have responsibilities. So we must speak of responsibilities of "businessmen", not of firms.

An executive is an employee of the owners (shareholders). His responsibility is to conduct the business in accordance with their desires, which generally will be to make as much money as possible.

If executives pursue **social responsibility**, they spend the money of company owners for general interest. That is, they impose taxes on the company. Executives who pursue social responsibility are like civil servants. But then they should be chosen through a political process. The doctrine of social responsibility is frequently a cloak for actions that are justified by self-interest. The doctrine of social responsibility undermines the foundations of society, because it strengthens the view that the pursuit of profits is wicked, immoral, and must be controlled by external forces.

The Stakeholder View – Edward Freeman:
According to this theory, business can be understood "as a set of relationships among groups that have a stake in the activities that make up the business". These groups are called **stakeholders**.

Exist two kind of stakeholders:
- **Primary**, those who are vital to growth and survival of any business (customers, employees, suppliers, communities, and "financiers").
- **Secondary**, those who affect primary stakeholders (media, government, competitors, etc.)

Stakeholder theory implies that firms should satisfy all stakeholders, otherwise firms cannot sustain their performance.
Unsatisfied primary stakeholders withdraw their contributions, which are essential to a firm's performance.
Unsatisfied secondary stakeholders have the means to influence negatively primary stakeholders or make life hard for the firm.

Managing for stakeholders means balancing and keeping an alignment among the various stakeholder interests.

There are trade-offs but different interests of the various stakeholder groups tend to go together over time. So, managing for stakeholders requires firms to adopt a long-term perspective.

Firms should have a purpose, a sense of what they stand for; this includes creating value for at least costumers and employees. This purpose is sometimes stated in "mission statement".

	Shareholder-based view	Stakeholder-based view
Purpose of the firm	Maximize profit	Satisfy key stakeholders
Accountability of top managers	To shareholders	To key stakeholders
Role of profit	End	Means
Role of stakeholders' satisfaction	Means	End

Governance and Management - Session 06.

Companies are legal entities made up of an association of members (people or other companies; the responsibilities for all the contracts are to be reconducted in the end to the CEO).

Members share **resources** (money, instrumental goods, work) to carry out economic activity.

The law and the company's "**constitution**" define the **rights** and **duties** of members, such as how company shares can be sold to others or profits are distributed.

Exist two **types of companies**:

- **Partnerships** are used by **small business**. Partners are **personally liable for financial obligations**. When business grows, risk may become too large. The biggest potential governance problem is personal conflict among members. It is more trustable, therefore it's easier to receive funds from banks, having employees and deal with suppliers.

- **Corporations** are legal entities in which owners (shareholders) have **limited liability**. The company has to be transparent, having a financial statement. Usually **large firms**, because the legal entity is too costly and complex for small business. **Owners do not generally manage the company** (directors are in charge).

The managerial component of firms it's mainly composed of **Shareholders**, **Board of Directors** and **Top Managers**.

Crucial is the role of the **Board of Directors**, composed of both **Independent Non Executive Directors (INED)** and **Connected Non-Executive Directors (CNED)**, the **CEO** and a **Chairman**. Overall, the board's task is to direct the company, this activity can be seen to involve four basic elements:
- **Strategy formulation,** at a very broad level.
- **Policy making**, approves relevant proposals by CEO and other executive directors (paying dividends).
- **Accountability,** must report financial information and corporate activities to shareholders and other stakeholders with legitimate claims to accountability.
- **Supervision of managers**, collect information and act on it when necessary.
-

Boards of Directors can be:

- **Unitary**, when a company has a single governing body, the board is known as a "unitary board", they are supposed to balance between executive directors and non-executive directors.

- **Two-Tier**, when a company has two governing body: the upper, **supervisory board**, and the lower, **management board** or committee. The supervisory board is composed entirely of outside directors and the management board entirely of executive directors. Half of the members of supervisory boards represent the interests of the employees and are appointed through the trades' union organizations. The remaining supervisory board members represent the interest of the shareholders and are appointed by them. In practice, members of the management board attend meetings of the supervisory board, but have no vote. The executive members present their strategies, management plans, and budgets to the supervisory board for comment and approval. The power of supervisory board lies in its ability to appoint to and remove members from the executive board.

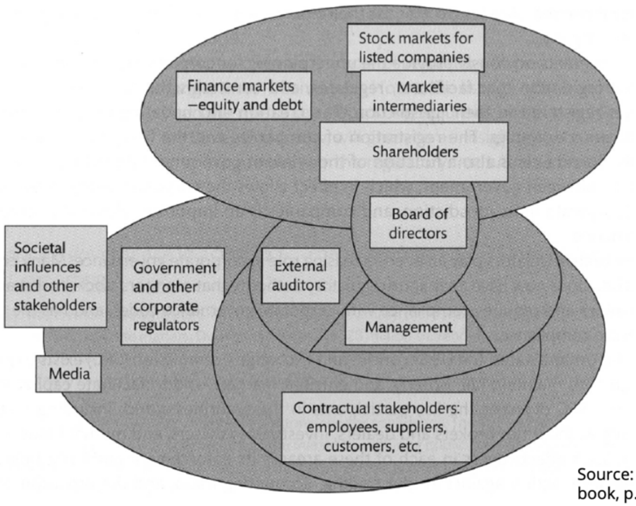
Corporate Governance - The evolution of companies

At the beginning, the **owner is also the manager**.
Then, the **company grows**, and owners hire **professional managers**.
The company can also open the doors to outside shareholders (financial investors), who are not interested in controlling the company, but only in participating in profits.
A further step for some companies is when they "**go public**", they **get listed in a stock exchange**. They float part of capital and commit to transparency requirements.

Public companies, those that are **listed in a stock exchange** (irrespective of whether ownership is fragmented or closely held).
Private companies, those that are **non-listed**.
Some small companies are listed and many big companies are private (**IKEA**, Ferrero, Saudi Aramco).

In public companies, **ownership may be fragmented** among many shareholders and **managers escape owners' control**, because no one has a sufficient percent of shares to appoint the corporate governance, furthermore if the firm is going well.

The **separation between ownership and control** was first noticed by Berle & Means in 1932. Defined as a situation in which no single owner or group of owners are able to control the company. Anyway, the separation between ownership and control it is not a frequent phenomenon, the majority of family firms have no separation of ownership and control (owners are managers or keep managers under control). Concentrated ownership is possible even without families (state-owned enterprises, ENEL/ENI). However, in all corporations, the board of directors is where all big decisions are approved.



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Source: your book, p. 186.

The corporate governance "**is the framework by which the relationships among management, board of directors, controlling shareholders, minority shareholders and other stakeholders are balanced**", therefore can be defined according to different perspectives:

- **Operational perspective**, "the system by which companies are directed and controlled", and further explained that boards of directors are responsible for the governance of their companies, while the shareholders' role in governance is to appoint the auditors, and you satisfy themselves that an appropriate governance structure is in place.

- **Relationship perspective**, "the corporate governance structure specifies the distribution of rights and responsibilities among the different participants in the organization - such as the board, managers, shareholders, and other stakeholder – and lays down the rules and procedures for decision making.

- **Stakeholder perspective**, "corporate governance is the process by which corporations are made responsive to the rights and wishes of stakeholders".

- **Financial economics perspective**, "corporate governance deals with the way suppliers of finance assure themselves of getting a return on their investment".

- **Societal perspective**, "corporate governance is concerned with holding the balance between economic and social goals and between individual and communal goals. The corporate governance framework is there to encourage the efficient use of resources and equally to require accountability for the stewardship of those resources. The aim is to align as nearly as possible as the interests of individuals, corporations and society.

Crucial for corporate governance are the role of **Auditors** and **Audit Committees**, now required by all the codes of good practice in corporate governance. For public listed companies, the stock market and their listing rules are, clearly, vitally significant to corporate governance. The rules that govern the stock market on which the company's shares are listed and in particular the requirements laid down for listing are fundamental to the effective governance of listed companies.
In the original model of the corporation, shares were held by individual shareholders who interacted directly with their company. Today, although individual investors do have a significant share in some markets, institutional investors play a very significant part in most. A further complication can arise if the financial institution holding shares lend them as security for other transactions. This situation can make it difficult for companies to know who their voting shareholders are, and for those shareholders to exercise their proxy votes and to take part in the governance of the company.

The disadvantages in huge fragmentated listed companies are, for example, the inability of small shareholders to express their opinion in the board, therefore small shareholders tend to **walk away** (selling shares) when they do not like managers, instead of trying and replace them.

Board of directors collect **proxies** (please give me the proxy to vote in support of…) from existing shareholders who are not interested in control and propose directors.

The **agency theory** describes the principal – agent relationship (transfer of responsibility).

Since corporate governance could be seen as a set of remedies to problems that arise when ownership and control are separated, we can define these problems as **Agency Costs** (Type I and Type II). The basic agency problem arises because of a separation between decision making, which is carried out by professional managers, and the bearing of residual risk by shareholders; difficulties faced by financiers in ensuring that their funds ae not expropriated or wasted on unattractive projects.

- **Type I agency costs**, they arise because of **conflicts between shareholders and managers** (managerial opportunism). They can be seen as the value loss to shareholders arising from the cost of minimizing divergences of interests between company shareholders and corporate managers. They arise because managers enjoy advantages that put them in the position to pursue their own interest instead of the interest of shareholders, like managerial discretion, information

asymmetries, a compensation that is never strictly linked to outcomes.
The **sources of conflict** can be

- **Moral Hazard**, when someone has incentives to under perform (overcompensation, related-party transaction, insider trading, etc.)
- **Earnings Retention**, managers usually prefer growing the firm instead of paying dividends.
- **Time Horizon**, managers usually spend a short period of their careers in a firm; therefore they're searching for short-term profits in order to gain success as individual, exchanging the long-term stability and sustainability of the firm.
- **Risk Aversion**, usually managers' income is linked to firm's performances, therefore managers may pursue investments and financing policies that minimize the risk of their company's equity.

- **Type II agency costs**, they arise because of **conflicts between majority and minority shareholders**. Firms' majority shareholders are the only able to appoint Board of Directors. Consequences of this fact are **information asymmetries**, because majority shareholders tend to be insiders and to identify with the company. Results are typical forms of opportunism such as **related-party transactions**, **overcompensation** and **fringe benefits**, **appropriation of assets**.

What can be done to prevent this agency problems, is paid through agency costs:

- **Monitoring costs** include attempts at improving managerial behaviour, such as auditing, definition of compensation, searching for right managers. (Payed by Principal).

- **Bonding costs** are payed to guarantee that behaviour is correct such as reporting and procedures. (Payed by Managers).

- **Residual Loss** includes all damages caused by managers behaviour which haven't been prevented. (Payed by Principal).

Corporate governance duty is to minimize the sum of all these costs.

Agency cost are reduced by **corporate governance mechanisms**, which depend on a mix of **regulation and monitoring of managerial**

behaviour, **reactions by shareholders and other parties to agency costs**, **interest alignment between managers and shareholders**.

The mechanisms able to do so are:

- **Board composition**, shareholders should assure that non-executive directors monitor managers.
- **Concentration of Ownership (blockholding)**, reduces managerial discretion, but creates risk of type II agency costs.
- **Active Ownership**, investors who try to use ownership rights to change managers' behaviour. This technique could also be used by speculators to generate short-term profits (Carl Icahn & Apple 500 million $ investment).
- **Incentives**, connect managerial pay to outcomes (bonuses, stock options, stock grants), to align the interests of managers and shareholders. Disadvantages of this incentives could be excessive risk taking, short-termism and self-dealing.
- **Control Mechanisms**, internal auditing (including board committees), external auditing, financial markets regulation.
- **Reputation**, name and shame managers who behave improperly, including codes of conduct (golden rules of management), codes of conduct are voluntary but those who deviate from them must provide an explanation.
- **Market for corporate control**, the stock price of underperforming companies drops, making easy for other companies or investors to buy them, concentrate ownership and remove inefficient managers.

Chapter 3 – Economic Activities in Organizations - Session 09.

In advanced economic systems, firms can play a key role in producing economic goods, specifically private goods.

Economic activities carried out in firms can be grouped into **functional areas**, that is, subsets of processes characterized by a **common function** and by the **specialized skill sets** used in carrying out these processes.

Business areas are sets of processes relate to the same product/market. Business areas have their own costs and revenues. Firms may have one business area (mono-business firms) or more (multi-business or "diversified" firms).

For every firm, functional areas can be classified as follows:

- **Institutional Structure Design**, determines the overall design by which the firm is created, and how it evolves. Activities relating to institutional structure design revolve around the creation, basic configuration, transformation, and termination of the organization.

        - Founding the organization.
        - Defining or changing its legal status.
        - Designing governing bodies.
        - Defining shareholder structure.
        - Mergers, acquisitions, break-ups.
        - Partnerships and alliances.
        - Terminating the organization.

- **Operations**, refer to the extensive set of activities by which the firm actually carries out economic production of goods and services, most of the firms' employees are involved in operations.
  Operations are made up of five subsets:

    - **Core operations**, purchasing production factors, carrying out physical/technical transformation, selling products). Usually can be broken down into the following functional areas:
        - **Research & Development**, centers on activities which establish product features and production methods.
        - **Purchasing**, buying all production factors and facilities.
        - **Manufacturing**, centers on processing and assembling raw material and parts.
        - **Sales & Marketing**, involves selling the firm's products while optimizing economic profitability.

    - **Debt and Equity Management**, consists of that set of activities undertaken by the firm in order to cover its financial needs, that is, the need for financial resources which serve to establish the firm and support its development. When a firm utilizes *debt capital* for financing, costs are generated which are primarily associated with interest expenses on loans. Tapping into *equity capital* also implies a cost: compensation to be granted to shareholders.
    - **Management of non-core investments**, certain situations may arise in which the firm has a *surplus of funds*, over and above what it requires for core operations. A firm would do well to invest these surplus funds in order to earn supplemental revenues beyond those resulting from core operations.
    - **Insurance Management**, every organization is subject to general *economic risk* (inherent and non-transferable). Each organization, however, is also exposed to *particular risks* which can be "covered" by insurance. This type of risk relates to specific unfavourable events that is, a limited set of economic

events within the organization. These specific risks are negotiable against payment of an *insurance premium*. The aim is to provide various forms of coverage for damages resulting from possible negative events within the context of core operations, finance, non-core investments, and in special facets of tax management.

    - **Tax Management**, all firms are required to pay various kind of taxes in exchange for the right to utilize public goods provided by the State. *Computing and paying taxes* are activities referred to as tax management, which normally involves expenditure and not revenues.

- **Organization**,

    - **Organizational Design**, refers to designing the organizational structure of the firm. Tasks are defined and assigned to units that make up the structure of the organization.
    - **Human Resource Management**, all organizational systems pertaining to personnel, such as administering compensation and development.

- **Information**, involves gathering, processing, and disseminating data and information needed to make good decisions and to provide information to all of the firm's stakeholders. Extreme variety and complexity of recipients, purposes, rules, and technologies involved. Many functional areas are becoming very data-intensive. A central component of a firm's information system is given by financial statements, which measure a firm's performance.

Chapter 13 – The Design of Organizational Structures - Session 10.

Organizational structure is "**division of labour** and **patterns of coordination**, communication, workflow, and formal power that direct organizational activities".

The **division of labour** is the subdivision of work into separate jobs given to different workers. It coincides with **job specialization** that allows to increase work efficiency and can be both **Horizontal** (separation of tasks among peers) and **Vertical** (relation among supervisor and workers).

The **coordination of work activities** aims at avoiding misalignment of tasks, duplication of effort and mistiming of activities. It can be achieved through:

- **Informal Communication**, based on face to face interaction, using shared information and common mental models. Easier in small firms, but technology extends its use also in large ones. Firms tend to apply it also through: *Liaison roles* (among units), *Integrator roles* (within units) and *Temporary teams* (among units). It's aimed to form common mental models to synchronize work activities.

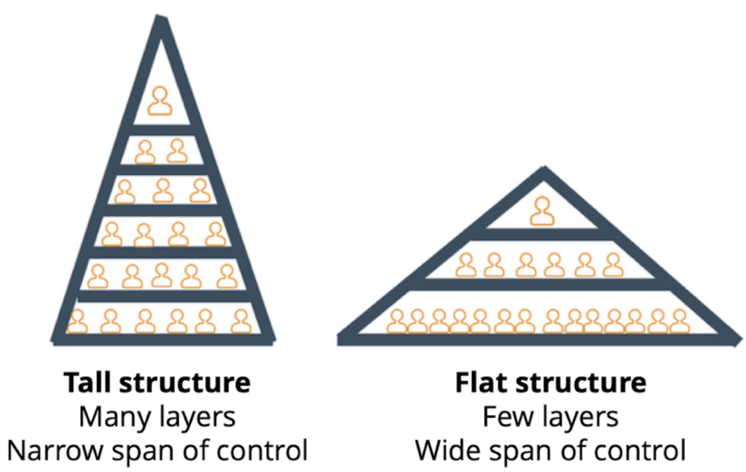
- **Formal Hierarchy,** it means that some employees (bosses) direct the work of others (subordinates). In organizational hierarchies, an employee receives orders only from one boss. The problems related to this approach are that bosses are extra-roles, not involved in making products, so costs for the firm. And also, that hierarchy reduces autonomy of workers and communication. Assigning legitimate power to individuals, who then use this power to direct work processes and allocate resources.

- **Standardization**, routine patterns of behaviour, prescribed ways of doing things. *Standardized Processes* (procedures, guidelines, job descriptions, flowcharts, software applications). *Standardized Outputs* (targets, product, specifications) and *Standardized Knowledge* (skills, training and experience).

The **four basic elements of organizational structures** are:

- **Span of Control**, it refers to the amount of people that directly report to a boss. Firms can have *narrow* or *wide* span of control. Wider spans of control are possible when: coordination can be achieved through informal communication or standardization, tasks are routine (supervision less required), there is low interdependence among employees (coordination less needed).

- **Centralization**, in centralized structures, decision making is held by a small group of people at the top of the hierarchy. In



decentralized structures, decision making is dispersed throughout the organization. Centralization tends to decline when the organization grows larger. Decision power in general should be located at the level with the best information. That level may vary in different areas of the organization, depending on sources and nature of information.

- **Formalization**, degree to which the firm standardizes work through rules, procedure and training. Firms become more formalized when they grow older because work activities become routine. Large firms also like formalization (hierarchy is costly and informal communication is difficult in these firms).

- **Departmentalization**, how employees and activities are grouped together. It establishes the chain of command among units. It focuses member of units on certain skills and shared mindsets. It encourages informal communication within units.

The combination of these elements generates **two main structures**, which are:

- **Mechanistic** Structure (TALL), designed to induce people to be predictable and accountable: *narrow span of control*, *high centralization (every decision is taken at upper levels), high formalization (everything is written down)*.

- **Organic** Structure (FLAT), designed to induce people take initiative, innovate, and adapt to changing conditions: *wide span of control (If the product fail, it isn't easy to pinpoint who has the fault), low centralization, low formalization*.

The main types of Organizational Structures

Organizational design is about choosing a proper way of dividing labour and ensure coordination. A proper design should be in line with the ***Environment*** (dynamism, complexity, diversity, munificence), the ***Size of the organization***, ***Technologies*** (task variability, task analysability), *the* ***Strategy of the firm*** (innovation vs low cost).

A fundamental design decision is which **type** of organizational structure to adopt, for example how to departmentalize activities.

There exist three main types:

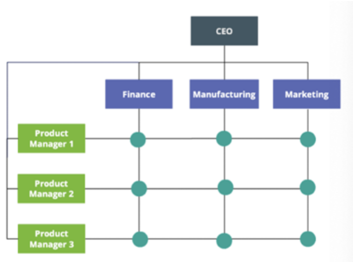
- **Functional Structure**, the first-level units are arranged by task similarity. Mainly used in **small organizations**, **mono-product or related** product lines and in **stable markets and products**.
  The **advantages** of this type are: *scale economies*, *learning and capability building*, *allows standardized control systems*.

  The **disadvantages** are that *cannot manage diverse businesses*, *functions develop their own goals, values, norms, making cross-functional coordination difficult*.

- **Divisional Structure**, the first-level of units are grouped by outputs (products, clients or geographical regions). Divisions are "***mini firms***", accountable for their profits. **Headquarters** provide planning, budgeting, and services to divisions.
  The **advantages** of this type are: *Good for large companies with diverse product/clients/regions, decentralized decision making, building block structure – accommodates growth*.

  The **disadvantages** are *duplication of functions, divisions compete for HQ resources, silos of knowledge, no synergies*.

- **Matrix Structure**, the first-level of units for both **functions** and **outputs**. Employees or units are "*dots*" in the matrix. They belong to a function, but they work for one/more products, clients, etc.
  Common variant: **project-functional** matrix where employees are temporarily assigned to projects (consultants, universities, software houses).



  The **advantages** of this type are: *No duplication of functions, potentially better communication, flexibility, innovation,*

focuses specialists on outputs, knowledge sharing within specialty.
The **disadvantages** are *two bosses dilutes accountability, more conflict, organizational politics, and stress*.

Other types of structure are:

- **Simple**, all employees report directly to the owner. Minimal structure for small or new-born organization.

- **Team-based**, employees are assigned to self-directed teams who are responsible for specific activities (developing a software, running a manufacturing plant). Usually part of broader functional or divisional structures.

- **c**. It's an alliance of several organizations for the purpose of creating a product or serving a client.

Chapter – Strategy and the Logic of Value Creation and Distribution - Session 11.

The **economic profits** achieved by firms are the result of:
- The **average economic profit of the industry** in which they operate (*industry-level profitability*).
- The **ability to achieve better economic profits than rivals** in the industry (*within-industry variance*).

An industry is a group of firms that produce goods or services that are **close substitutes** (banking industry, automobile industry, gas utilities industry).
Firms in an industry compete for the **same costumers**; so they are often engaged in a **zero-sum game** in which they have to overcome each other in order to achieve above-average returns.
Industries are more or less profitable, as a **consequence of a set of forces that shape competition**.

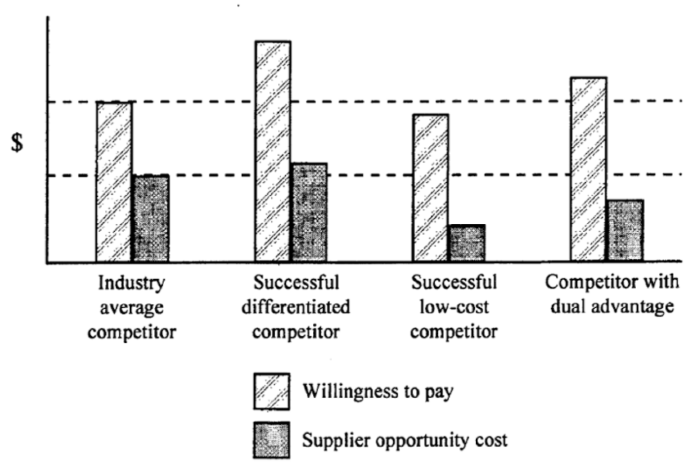
The most profitable industries are **Toiletry & Cosmetics**, **Tobacco, Soft Drinks** and **Pharmaceutical industries**. As a contrary **Steel and Power industries** aren't very profitable.
Every industry profits are the average of the differences in profits within the industry, therefore between the firms.

A firm is said to have a competitive advantage over its rivals if it has driven a wide wedge between the willingness to pay it generates among buyers and the costs it incurs, indeed, a wider wedge than its competitors have achieved.
A firm with a **competitive advantage** is positioned to earn superior profits within its industry. Having a competitive advantage depends on being **unique** (*in a valuable way*), that is, on doing something that cannot be replaced or imitated by competitors. **Uniqueness means**

that the value created by the firm is larger than the value that competitors can create.
The essence of creating advantage is finding an integrated set of choices that distinguishes a firm from its rivals. The choices that establish a firm's advantage also influence whether the advantage can be sustained.

A costumer's **willingness to pay** for a product or service is the *maximum amount of money that a costumer would be willing to part with in order to order to obtain the product or service*.

The concept of **supplier opportunity cost** is precisely symmetrical to willingness to pay. It *is the smallest amount of money that a supplier*



will accept for the service and resources requested to produce a good or service. We call this an "opportunity cost" because it is dictated by the best opportunities that the suppliers have to sell their services and resources elsewhere.

The **total value** created by a transaction is the difference between the costumers' WTP and the supplier opportunity cost.

The **Added Value** is the *maximal value created in a transaction minus the maximal value that could be created without the firm*. In practice, the added value of a firm is the value created by its goods/services compared to the value created by the next best option for the customers. The added value is important because, assuming that no barriers to competition exist ("unrestricted bargaining"), a firm can achieve positive economic profits only if it has positive added value. Said otherwise, *the amount of value that a company can claim cannot exceed its added value*. As a consequence, *a firm will be able to apply a price that is no larger than the sum of its costs and the added value*.

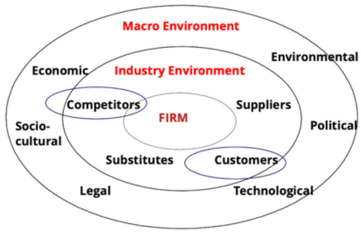
Therefore **Final Price** = **Supplier Opportunity Cost** + **Added Value** – **0.01 Discount**.

Ultimately, **competitive advantage** consists in **added value**.

In turn, having added value depends on finding better ways to make and sell products, considering the network of suppliers, customers, and complementors that participate to transactions. Two strategies:

- Focusing on **raising costumers' WTP** without a commensurate increase in costs (**differentiation strategy**, by which we mean that the firm has boosted the willingness of costumers to pay, not simply that the company is different from its competitors).

- Focusing on **reducing costs** without a commensurate decrease in WTP (**low cost strategy**), better management of supplier relations is often underrated.



Rarely, firms may even **achieve higher WTP and lower costs** at the same time (**dual advantage**).

Strategic Analysis of the Business Environment – The Analysis of Business Environment - Session 12, Session 13.

The analysis of the external business environment is indispensable for strategic decision making so as to ensure that the decisions it takes today prepare the company for the future. The external environment decides whether the strategies of firms are successful. The **environment changes continuously**, but many firms are **unable to see the changes** that are coming (and sometimes those that are already happening). What should a company look at to make sense of the current – or future – business environment, threats and opportunities aren't easy to pinpoint.

The strategy field has developed several concepts and frameworks to structure the analysis of external environment into manageable pieces, and help strategist ask the right questions:

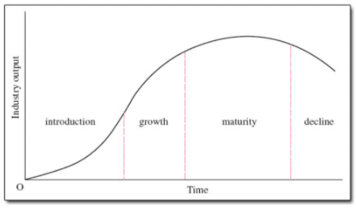
- **Analysis of the Macro Environment**, broad developments in the external context beyond the boundaries of a given industry. It impacts on all industries. But the impact is different in each specific industry.

  PricewaterhouseCoopers (PwC) identified five "megatrends" affecting many industries: **Demographic and Social Change**, **Shift in Global Economic Power**, **Rapid Urbanisation**, **Climate Change and Resource Scarcity**, **Technological Breakthroughs**.

In strategy, the **PESTEL** framework is often used to capture macro-environmental factors in a structured way: **P**olitical, **E**conomic, **S**ocio-cultural, **T**echnological, **E**nvironmental, **L**egal.

To apply the PESTEL framework should be aware that looking too closely at the industry isn't correct because even it's boundaries are affected by changes. Although the framework does not necessarily imply a geographical focus, many of its dimensions vary at the level of the country or region. For scanning and assessing the opportunities and risks of entry and operation in foreign markets, country level analysis is particularly appropriate. It occurs to define a time perspective that is appropriate for the industry and to understand whether the trends are real or not. (e.g. **Luxottica** is favoured by the macro trend of increasing and ageing amount of people)

- **Analysis of the Industry Environment**, factors specific to the industry, resulting in statements about the industry overall.
  Industry is a natural unit of external analysis in strategy. While the definition of industry boundaries is a subjective choice, depending on the purpose of the analysis, three questions are commonly used to draw clear industry boundaries: *"What is the offer?"; "For whom?"; "Where?"*.



Generally, it is good practice to use the narrowest market definition that fits the analyst's purpose, since this provides more specific and actionable insights. In practice, the choice of boundaries is often constrained by data availability.

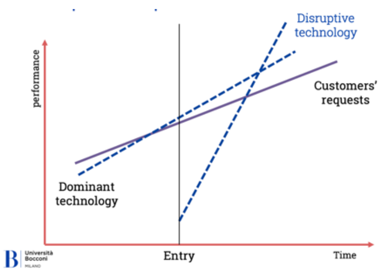
Most strategic analysts pay close attention to statistics on the size and growth trends of the industry and forecasts of future growth. Market size and growth indicate an industry's ability to create value. The drivers of industry growth are: *demographic factors, costumer preferences, growth of the economy, reduction of costs, regulations, complementary goods, international demand*.

While an industry's growth can generally be explained by the fundamental supply and demand drivers, a recurrent evolutionary pattern with distinct phases is observed across many industries. The **industry life cycle** distinguish between four phases:

- **Introduction**, may result from **one firm's innovation**, then imitators enter the industry. The **growth initially is very slow**, customers do not know or trust the product. **High product prices**, because of small volume and immaturity of product technologies. **Existent distribution channels may not accept the product**, building new one may be necessary. Technical know-how and components are in **rare supply**. The main challenge in a new industry is to demonstrate superior value creation relative to other industries (substitutes), at least for some customers niches with unmet needs.

- **Growth**, the **product improves** and comes to be accepted by the large public, first-time demand expands rapidly. **Prices begin to fall**, thanks to economies of scale and growing standardization of the product. Diffusion of technical know-how lowers costs but also reduces entry-barriers; many **new competitors** enter the industry. Rapid market growth means low competitive pressure, since any firm can expand its turnover without cutting prices. Massive new **productive capacity** is built.

- **Maturity**, The **market is gradually saturated**. Demand driven by replacements not first-time adoption. Shrinking technical opportunities for product innovation. **Slow market growth** ignites competition for market share, which drives down prices. Firms strive to **reduce costs** and to **build brand loyalty**. Competitors with high costs or **weak brands exit** the industry (sometimes they are acquired by other firms), leading to **industry consolidation**. There are also firms able to catch opportunities in the maturity phase, like IKEA, Swatch, Nespresso, Ryanair and Airbnb.



- **Decline**, it's characterized by **negative growth** due to changes in technology, social preferences, demographics and so on. **Increased rivalry**, since firms try to compensate negative growth with larger market shares. **Excess capacity** in the industry and price competition. The appearance of a **substitute product** can kill the industry (typing machines), but sometimes the market shrinks to a smaller size and then goes on (vinyl records). Profitability of the industry highly dependent on **exit barriers** that determine the level of excess capacity (obstacles to leave the industry or selling the equipments).

The **industry life cycle** is an empirical regularity, not a deterministic destiny. This model allows predictive model for the evolution of WTP and customers' demand; it connects competitive dynamics to demand dynamics; it emphasizes the possibility of decline; it's less important for industries that are structurally mature or that are structurally far from saturation of the market; big changes in technologies or business modal can change how revenue is obtained, modyfing the cycle.

The **consecutive chain of supplier-buyer relationships** in an industry is the **industry value chain**. The chain is the sequence of firms or other organizations that are involved in producing and delivering a product or service. The sequence begins with basic supplier of raw material and extends all the way to the final costumer. The result is an end to end picture of how products and services are built up, from initial inputs to the end costumer.
For example, the value chain of the diamond industry comprises the four stages of rough diamond exploration and sales, cutting and polishing, jewellery manufacturing, and retail sales.
In strategy analysis terms, each of the four stages in the diamond chain represents an industry in its own right.

An **industry** is a *set of firms* (or business units) that sell similar products to the same costumer, while a **market** is a *set of costumers* defined by a given product, distribution channel, geographical area, or, purchasing behaviour (segments).
Firms in an industry usually serve multiple markets.

In the industry, **rivals** are those firms who compete in the same industry. **Substitutes** are those who compete from outside of the industry (airplanes vs trains). We can define a difference from the two on the **nature of the product** or the **technology involved**, but also on **how revenues are collected**. Although the costumers are similar, substitutes have cost structures and entry barriers that are different than those of the industry rivals.

It may be difficult to establish the industry's boundaries due to:

- Different **costumer segments** (Ferrari - Peugeot)
- Different **distribution channels** (Esselunga - Deliveroo)
- Different **geographical areas** (Alitalia – Emirates).

The criterion can sometimes be choosing the narrowest industry that is coherent with hypotheses about **competition** (what happens to the demand of B when A reduces prices?)

The **Five Forces Model** is the most prominent framework for industry analysis is that of Michael Porter, who advocated structural analysis of competitive pressures to understand an industry's profitability.

Porter proposed five forces that jointly determine an **industry's activeness in terms of profitability**:

- The ***intensity of rivalry*** among industry incumbents. The rivalry is strengthened if there are *many firms, equal in size and capability*, the *market growth is slow*, there are *high fixed costs*, there is a *lack of differentiation opportunities* and *high exit barriers*.

- The ***threat of new entry***, barriers to entry are structural factors that prevent or make the entry expensive, such that *economies of scale*, *other cost disadvantages* for the new entrant that arise when the incumbents have privileged access to crucial resources; *product differentiation, capital requirements, switching costs, distribution channels*, *government policy and expected retaliation (response by existing competitors to entry).*

- The ***threat of substitutes products***, the competitive threat of substitutes is stronger when they are: *attractively priced, readily available, high quality and perform well, customer switching costs are low*. In general, any increase in quality or decrease in price of a substitute will put pressure on the industry to reduce prices to avoid losing customers (thus reducing profitability).

- The ***bargaining power of suppliers*** to the industry (upstream). Suppliers have bargaining power when the *item is crucial to buyers*, it is *costly for buyers to switch suppliers* (Airbus – Boeing), *threat to integrate forward into buyer's industry* or there are only a *few large suppliers*.

- The ***bargaining power of distribution channels and buyers*** (downstream). Buyers have bargaining power *when they are large*, they *threat to integrate backward into the seller's industry*, buyers can *switch to another product without high costs*.

An ideal situation for an industry is low rivalry, high entry barriers, little threat from substitutes and little bargaining power both of suppliers and buyers.

The industry concentration depends on how market shares are distributed among competitors, **CR4 Index**: is the sum of the market shares of the four biggest firms. The higher the index, the higher the concentration.

The "***Sixth force***" are **complementors**.
Goods and services that make the industry's products **more valuable**. Complementors can create **additional demand** for the industry but they can also **compete with the industry in appropriating value** (*the more expensive the complementor, the lower the value appropriated by the industry*).

Porter says that he never wanted to add complementors to the framework because *they already impact the bargaining power of costumers*.

- **Analysis of Customers and Competitors**, critical information about costumer segments and specific competitors' abilities and strategies in the industry.

  Customers of an industry vary in terms of many distinct characteristics.
  Groups of customers who share given characteristics that influence their purchase behaviour are called **segments**.
  Segmentation of market allows firms to:

  - Choose **which segments to target**
  - **Design specific offerings** for different segments
  - **Adapt marketing strategies** to specific segments.

  Typical criteria for segmentation are **Geographics**, **Demographics**, **Psychographics** and **Behavioural**.

  Firms need to know objective data about the **Competitors**, such as market share, growth rates, product offerings, target segments, or channels of distribution.
  Firms also need to understand the competitive approach of their rivals, based on:
  - Their **future goals** (*growth rather than focus on a niche*)
  - Their **current strategies** (*positioning, vertical integration, domains of activity*)
  - Their **assumptions on the industry** *(trends they believe are important)*
  - Their **resources and capabilities** *(technology, human resources, routines and financial resources).*