PLUG-IN B1 Business Basics

LEARNING OUTCOMES

1. Define the three common business forms.
2. List and describe the seven departments commonly found in most organizations.
3. Describe a transaction and its importance to the accounting department.
4. Identify the four primary financial statements used by most organizations.
5. Define the relationship between sales and marketing, along with a brief discussion of the marketing mix.
6. Define business process reengineering and explain how an organization can use it to transform its business.

Introduction

A sign posted beside a road in Colorado states, "Failing to plan is planning to fail." Playnix Toys posted the sign after successfully completing its 20th year in the toy business in Colorado. The company's mission is to provide a superior selection of high-end toys for children of all ages. When the company began, it generated interest by using unique marketing strategies and promotions. The toy business has a lot of tough competition. Large chain stores such as Wal-Mart and Target offer toys at deep discount prices. Finding the right strategy to remain competitive is difficult in this industry, as FAO Schwarz discovered when it filed for bankruptcy after 143 years in the toy business.

This plug-in introduces basic business fundamentals beginning with the three most common business structures—sole proprietorship, partnership, and corporation. It then focuses on the internal operations of a corporation including accounting, finance, human resources, sales, marketing, operations/production, and management information systems.

Types of Business

Businesses come in all shapes and sizes and exist to sell products or perform services. Businesses make profits or incur losses. A ***profit*** occurs when businesses sell products or services for more than they cost to produce. A ***loss*** occurs when

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businesses sell products or services for less then they cost to produce. Businesses typically organize in one of the following types:

1. Sole proprietorship
2. Partnership
3. Corporation

SOLE PROPRIETORSHIP

The ***sole proprietorship*** is a business form in which a single person is the sole owner and is personally responsible for all the profits and losses of the business. The sole proprietorship is the quickest and easiest way to set up a business operation. No prerequisites or specific costs are associated with starting a sole proprietorship. A simple business license costing around $25 from the local county clerk is all that is required to start a sole proprietorship. The person who starts the sole proprietorship is the sole owner.

PARTNERSHIP

Partnerships are similar to sole proprietorships, except that this legal structure allows for more than one owner. Each partner is personally responsible for all the profits and losses of the business. Similar to the sole proprietorship, starting a partnership is a relatively easy process since there are no prerequisites or specific costs required. When starting a partnership, it is wise to have a lawyer draft a partnership agreement. A ***partnership agreement*** is a legal agreement between two or more business partners that outlines core business issues. Partnership agreements typically include:

- Amount of capital each partner expects to contribute. ***Capital*** represents money whose purpose is to make more money, for example, the money used to buy a rental property or a business.
- Duties and responsibilities expected from each partner.
- Expectations for sharing profits and losses.
- Partners' salary requirements.
- Methods for conflict resolution.
- Methods for dissolving the partnership.

Limited Partnership

A ***limited partnership*** is much like a general partnership except for one important fundamental difference; the law protects the limited partner from being responsible for all of the partnership's losses. The limited partner's legal liability in the business is limited to the amount of his or her investment. The limited partnership enables this special type of investor to share in the partnership profits without being exposed to its losses in the event the company goes out of business. However, this protection exists only as long as the limited partner does not play an active role in the operation of the business.

CORPORATION

The corporation is the most sophisticated form of business entity and the most common among large companies. The ***corporation (also called organization, enterprise,*** or ***business***) is an artificially created legal entity that exists separate and apart from those individuals who created it and carry on its operations. In a corporation, the business entity is separate from the business owners. ***Shareholder*** is another term for business owners. An important advantage of using a corporation as a business form is that it offers the shareholders limited liability. ***Limited liability*** means that the shareholders are not personally liable for the losses incurred by the corporation. In most instances, financial losses incurred by a corporation are limited to the assets owned by the corporation. Shareholders' personal assets, such as their homes or investments, cannot be claimed to pay off debt or losses incurred by the corporation.

There are two general types of corporations—for profit and not for profit. ***For profit corporations*** primarily focus on making money and all profits and losses are shared by the business owners. ***Not for profit*** (or ***nonprofit***) ***corporations*** usually exist to accomplish some charitable, humanitarian, or educational purpose, and the profits and losses are not shared by the business owners. Donations to nonprofit businesses may be tax deductible for the donor. Typical examples include hospitals, colleges, universities, and foundations.

Eleanor Josaitis is a tiny 72-year-old woman who co-founded the Detroit civil-rights group Focus: HOPE. Focus: HOPE, founded in 1968, began as a food program serving pregnant women, new mothers, and their children. Josaitis has built the nonprofit organization from a basement operation run by a handful of friends into a sprawling 40-acre campus in Detroit that now employs over 500 people, boasts more than 50,000 volunteers and donors, and has helped over 30,000 people become gainfully employed.

Josaitis and her team developed a technical school to help job seekers gain certifications in IT support. They operate a machinists' training program that funnels people into the employment pipeline at local automotive companies. The organization also teams up with local universities to help disadvantaged students receive college educations, and it runs a child care center to make sure all these opportunities are available to working and single parents. Josaitis states that the most courageous act she has performed in her life occurred 36 years ago when she turned off her television, got up off the couch, and decided to do something. "You have to have the guts to try something, because you won't change a thing by sitting in front of the TV with the clicker in your hand," Josaitis said.

Forming a corporation typically costs several hundred dollars in fees, and the owners must file a charter within the respective state. The charter typically includes:

- Purpose of the intended corporation.
- Names and addresses of the incorporators.
- Amount and types of stock the corporation will be authorized to issue.
- Rights and privileges of the shareholders.

FIGURE B1.1

Reasons Businesses Choose to Incorporate

Reasons Businesses Choose to Incorporate	
Limited liability	In most instances, financial losses or judgments against the corporation are limited to the assets owned by the corporation.
Unlimited life	Unlike sole proprietorships and partnerships, the life of the corporation is not dependent on the life of a particular individual or individuals. It can continue indefinitely until it accomplishes its objective, merges with another business, or goes bankrupt. Unless stated otherwise, it could go on indefinitely.
Transferability of shares	It is easy to sell, transfer, or give the ownership interest in a corporation to another person. The process of divesting sole proprietorships or partnerships can be cumbersome and costly. Property has to be re-titled, new deeds drawn, and other administrative steps taken any time the slightest change of ownership occurs. With a corporation, all of the individual owners' rights and privileges are represented by the shares of stock they own. Corporations can quickly transfer ownership by simply having the shareholders endorse the back of each stock certificate to another party.
Ability to raise investment capital	It is easy to attract new investors into a corporate entity because of limited liability and the easy transferability of ownership.

	Sole Proprietorship	Partnership	Corporation
Licensing	Local license, $25–$100	Partnership agreement, legal fees	Articles of incorporation through the Secretary of State
Income	Business flows directly into personal income	Distributions taken by partners, as agreed by partners	Business and personal earnings separate, depending on corporate structure
Liability	Owner is liable	Owners are liable	Only business is liable

FIGURE B1.2
Comparison of Business Structures

The most common reason for incurring the cost of setting up a corporation is the recognition that the shareholder is not legally liable for the actions of the corporation. Figure B1.1 displays the primary reasons businesses choose to incorporate.

The Limited Liability Corporation (LLC)

The ***limited liability corporation (LLC)*** is a hybrid entity that has the legal protections of a corporation and the ability to be taxed (one time) as a partnership. A company can form an LLC for any lawful business as long as the nature of the business is not banking, insurance, and certain professional service operations. By simply filing articles of organization with the respective state agency, an LLC takes on a separate identity similar to a corporation, but without the tax problems of the corporation. Figure B1.2 summarizes the primary differences between the three most common business structures.

Internal Operations of a Corporation

The majority of corporations use different specialized departments to perform the unique operations required to run the business. These departments commonly include accounting, finance, human resources, sales, marketing, operations/production, and management information systems (see Figure B1.3).

Accounting

The ***accounting department*** provides quantitative information about the finances of the business including recording, measuring, and describing financial information. People tend to use the terms *accounting* and *bookkeeping* synonymously;

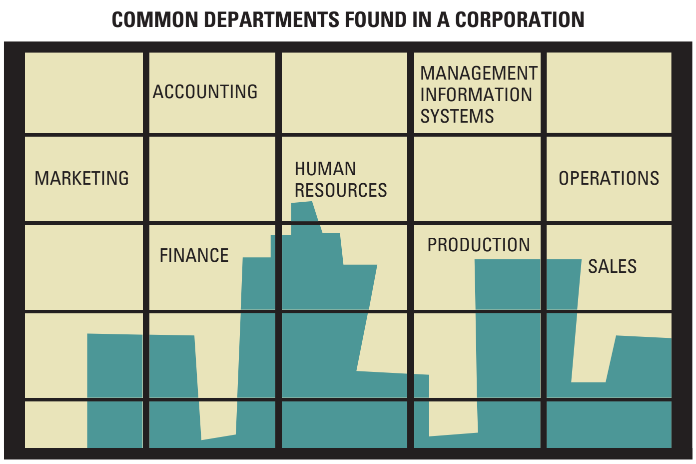


FIGURE B1.3
Departmental Structure of a Typical Organization

however, the two are different. ***Bookkeeping*** is the actual recording of the business's transactions, without any analysis of the information. ***Accounting*** analyzes the transactional information of the business so the owners and investors can make sound economic decisions.

The two primary types of accounting are financial and managerial. ***Financial accounting*** involves preparing financial reports that provide information about the business's performance to external parties such as investors, creditors, and tax authorities. Financial accounting must follow strict guidelines known as Generally Accepted Accounting Principles (GAAP). ***Managerial accounting*** involves analyzing business operations for internal decision making and does not have to follow any rules issued by standard-setting bodies such as GAAP.

FINANCIAL STATEMENTS

All businesses operate using the same basic element, the transaction. A ***transaction*** is an exchange or transfer of goods, services, or funds involving two or more people. Each time a transaction occurs a source document captures all of the key data involved with the transaction. The ***source document*** describes the basic transaction data such as its date, purpose, and amount and includes cash receipts, canceled checks, invoices, customer refunds, employee time sheet, etc. The source document is the beginning step in the accounting process and serves as evidence that the transaction occurred. ***Financial statements*** are the written records of the financial status of the business that allow interested parties to evaluate the profitability and solvency of the business. ***Solvency*** represents the ability of the business to pay its bills and service its debt. The financial statements are the final product of the accountant's analysis of the business transactions. Preparing the financial statements is a major undertaking and requires a significant amount of effort. Financial statements must be understandable, timely, relevant, fair, and objective in order to be useful. The four primary financial statements include:

- Balance sheet.
- Income statement.
- Statement of owner's equity.
- Statement of cash flows.

Balance Sheet

The ***balance sheet*** gives an accounting picture of property owned by a company and of claims against the property on a specific date. The balance sheet is based on the fundamental accounting principle that assets = liabilities + owner's equity. An ***asset*** is anything owned that has value or earning power. A ***liability*** is an obligation to make financial payments. ***Owner's equity*** is the portion of a company belonging to the owners. The left (debit) side of a balance sheet states assets. The right (credit) side shows liabilities and owners' equity. The two sides must be equal (balance). The balance sheet is like a snapshot of the position of an individual or business at one point in time (see Figure B1.4).

Income Statement

The ***income statement*** (also referred to as ***earnings report, operating statement, and profit-and-loss (P&L) statement***) reports operating results (revenues minus expenses) for a given time period ending at a specified date. ***Revenue*** refers to the amount earned resulting from the delivery or manufacture of a product or from the rendering of a service. Revenue can include sales from a product or an amount received for performing a service. ***Expenses*** refer to the costs incurred in operating and maintaining a business. The income statement reports a company's ***net income,*** or the amount of money remaining after paying taxes (see Figure B1.5).

ASSETS		LIABILITIES	
Current Assets		**Current Liabilities**	
Cash	$ 250,000	Accounts Payable	$ 150,000
Securities	$ 30,000	Loans (due < 1 year)	$ 750,000
Accounts Receivable	$ 1,500,000	Taxes	$ 200,000
Inventory	$ 2,920,000		
		Long-term Liabilities	
Fixed Assets	$ 7,500,000	Loans (due > 1 year)	$ 2,500,000
		Total Liabilities	$ 3,600,000
		Owner's Equity	$ 8,600,000
Total Assets	**$12,200,000**	**Total Liabilities + Owner's Equity**	**$12,200,000**

ASSETS = LIABILITIES + OWNER'S EQUITY

FIGURE B1.4
Balance Sheet Example

Income Statement	
Revenue (Sales)	$60,000,000
Cost of Goods Sold	$30,000,000
Gross Profit (Sales – Cost of Goods Sold)	$30,000,000
Operating Expenses	$7,000,000
Profit Before Taxes (Gross Profit – Operating Expenses)	$23,000,000
Taxes	$18,000,000
Net Profit (or Loss)	**$5,000,000**

FIGURE B1.5
Income Statement Example

Statement of Owner's Equity

The ***statement of owner's equity*** (also called the ***statement of retained earnings*** or ***equity statement***) tracks and communicates changes in the shareholder's earnings. Profitable organizations typically pay the shareholders dividends. ***Dividends*** are a distribution of earnings to shareholders.

Statement of Cash Flows

Cash flow represents the money an investment produces after subtracting cash expenses from income. The ***statement of cash flows*** summarizes sources and uses of cash, indicates whether enough cash is available to carry on routine operations, and offers an analysis of all business transactions, reporting where the firm obtained its cash and how it chose to allocate the cash. The cash flow statement shows where money comes from, how the company is going to spend it, and when the company will require additional cash. Companies typically project cash flow statements on a monthly basis for the current year and a quarterly basis for the next two to five years. A ***financial quarter*** indicates a three-month period (four quarters per year). Cash flow statements become less valid over time since numerous assumptions are required to project into the future.

When it comes to decreasing expenses and managing a company's cash flow, managers need to look at all costs. Ben Worthen, executive vice president and CIO of Manufacturers Bank in Los Angeles, states that everyone notices the million-dollar negotiation; however, a couple of thousand dollars here and there are just as important. When attempting to cut costs, Worthen listed every contract the bank had. He saved $5,000 by renegotiating a contract with the vendor who watered the plants, a vendor that most employees did not even know existed. He also saved $50,000 by renegotiating the contract with the bank's cleaning agency. "You need to think of everything when cutting costs," Worthen said. "$5,000 buys three or four laptops for salespersons."

Finance

Finance deals with the strategic financial issues associated with increasing the value of the business while observing applicable laws and social responsibilities. Financial decisions include such things as:

- How the company should raise and spend its capital.
- Where the company should invest its money.
- What portion of profits will be paid to shareholders in the form of dividends.
- Whether the company should merge with or acquire another business.

Financial decisions are short term (usually up to one year), medium term (one to seven years), or long term (more than seven years). The typical forms of financing include loans (debt or equity) or grants. Financing may be required for immediate use in business operations or for an investment.

FINANCIAL ANALYSIS

Different financial ratios are used to evaluate a company's performance. Companies can gain additional insight into their performance by comparing financial ratios against other companies in their industry. A few of the more common financial ratios include:

- **Internal rate of return (IRR)—**the rate at which the net present value of an investment equals zero.
- **Return on investment (ROI)—**indicates the earning power of a project and is measured by dividing the benefits of a project by the investment.
- **Cash flow analysis—**a means to conduct a periodic check on the company's financial health. A projected cash flow statement estimates what the stream of money will be in coming months or years, based on a history of sales and expenses. A monthly cash flow statement reveals the current state of affairs. The ability to perform a cash flow analysis is an essential skill for every business owner; it can be the difference between being able to open a business and being able to stay in business.
- **Break-even analysis—**a way to determine the volume of business required to make a profit at the current prices charged for the products or services. For example, if a promotional mailing costs $1,000 and each item generates $50 in revenue, the company must generate 20 sales to break even and cover the cost of the mailing. The ***break-even point*** is the point at which revenues equal costs. The point is located by performing a break-even analysis. All sales over the break-even point produce profits; any drop in sales below that point will produce losses (see Figure B1.6).

Human Resources

Human resources (HR) includes the policies, plans, and procedures for the effective management of employees (human resources). HR typically focuses on the following:

- Employee recruitment.
- Employee selection.

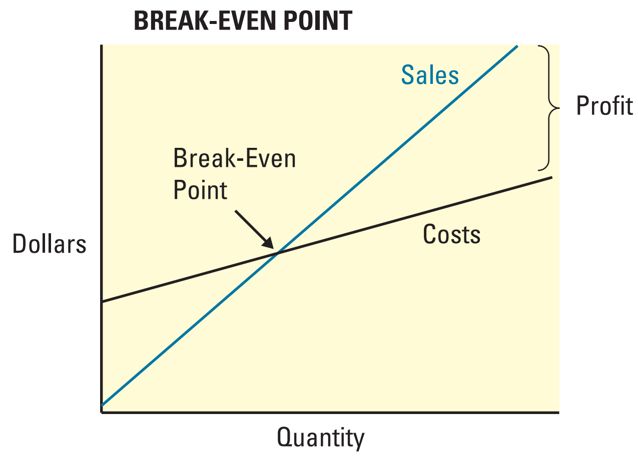


FIGURE B1.6
Break-Even Analysis

- Employee training and development.
- Employee appraisals, evaluations, and rewards.
- Employee communications.

The primary goal of HR is to instill employee commitment by creating an environment of shared values, innovation, flexibility, and empowerment. Most organizations recognize that focusing on strong HR practices that foster employee growth and satisfaction can significantly contribute to achieving business success. The most obvious way HR practices create business success is through quality employee selection. Hiring the right employee who suits the company's culture is difficult. Organizations create employee value by implementing employment practices such as training, skill development, and rewards. An organization that focuses on HR creates valuable employees with strategic business competencies.

MANAGEMENT TECHNIQUES

There may be no such thing as a best practice for managing people. Numerous management techniques are used by all different types of managers in a variety of industries. For example, Sears and Nordstrom are legends in the retailing industry; however, their approaches to HR are completely different. Sears is one of the pioneering companies in the science of employee selection, relying on some of the most sophisticated selection tests in American industry. Sears employees receive extensive training in company practices; management tracks employee attitudes and morale through frequent and rigorous employee surveys. The company provides its sales representatives, who work on salary rather than commission, with intensive training in Sears products, the company's operating systems, and sales techniques.

Nordstrom operates with virtually no formal personnel practices. Its hiring is decentralized, using no formal selection tests. Managers look for applicants with experience in customer contact, but the main desirable quality appears to be pleasant personalities and motivation. The company has only one rule in its personnel handbook: "Use your best judgment at all times." Individual salesclerks virtually run their areas as private stores. Nordstrom maintains a continuous stream of programs to motivate employees to provide intensive service, but it offers very little training. Its commission-based payroll system makes it possible for salesclerks to earn sizable incomes. Nordstrom sales personnel are ranked within each department according to their monthly sales; the most successful are promoted (almost all managers are promoted from within the company) and the least successful are terminated.

Sears and Nordstrom are both highly successful retailers, yet they operate using widely different recruitment policies. One of the biggest success factors for any business is the company's management and personnel. Employees must possess certain critical skills for the company to succeed. The HR department takes on the important task of hiring, training, evaluating, rewarding, and terminating employees. Effective HR goes far beyond executing a standard set of policies and procedures; it requires questioning and understanding the relationships between choices in managing people, the strategies and goals of the organization, and the possibilities presented by the external environment. Today's competitive environment features rapid technological change, increasingly global markets, and a diverse workforce comprising not just men and women with different sorts of career objectives, but also potential workers from diverse cultural and ethnic backgrounds. HR must ensure that the choices made in managing people are made sensibly and with clear purposes in mind.

Sales

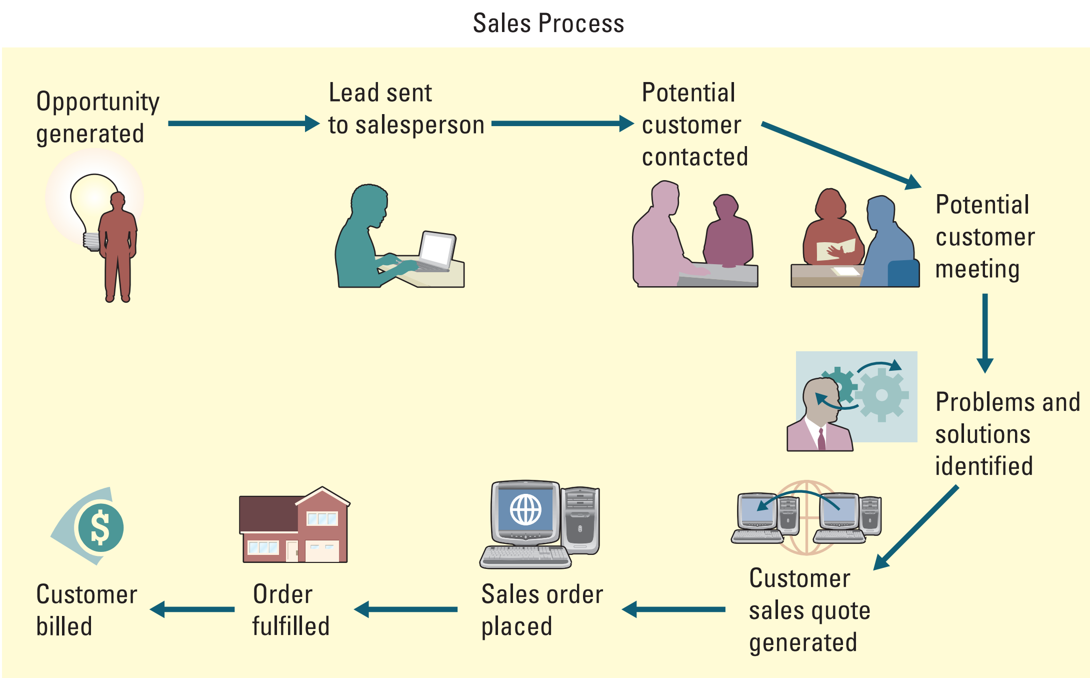
Sales is the function of selling a good or service and focuses on increasing customer sales, which increases company revenues. A salesperson has the main activity of selling a product or service. Many industries require a license before a salesperson can sell the products, such as real estate, insurance, and securities.

A common view of the sales department is to see the salespersons only concerned with making the sale now, without any regard to the cost of the sale to the business. This is called the hard sell, where the salesperson heavily pushes a product (even when the customer does not want the product) and where price cuts are given even if they cause financial losses for the company. A broader view of the sales department sees it as taking on the task of building strong customer relationships where the primary emphasis is on securing new customers and keeping current customers satisfied. Many sales departments are currently focusing on building strong customer relationships.

THE SALES PROCESS

Figure B1.7 depicts the typical sales process, which begins with an opportunity and ends with billing the customer for the sale. An opportunity is a name of a potential customer who might be interested in making a purchase (opportunities are also

FIGURE B1.7
The Sales Process



called *leads*). The company finds opportunities from a variety of sources such as mailing lists and customer inquiries. The name is sent to a salesperson who contacts the potential customer and sets up a meeting to discuss the products. During the meeting, all problems and issues are identified and resolved, and the salesperson generates a quote for the customer. If the customer decides to accept the quote, a sales order is placed. The company fulfills the order and delivers the product, and the process ends when the customer is billed.

MARKET SHARE

Sales figures offer a good indication of how well a company is performing. For example, high sales volumes typically indicate that a company is performing well. However, they do not always indicate how a firm is performing relative to its competitors. For example, changes in sales might simply reflect shifts in market size or in economic conditions. A sales increase might occur because the market increased in size, not because the company is performing better.

Measuring the proportion of the market that a firm captures is one way to measure a firm's performance relative to its competitors. This proportion is the firm's ***market share*** and is calculated by dividing the firm's sales by the total market sales for the entire industry. For example, if a firm's total sales (revenues) were $2 million and the sales for the entire industry were $10 million, the firm would have captured 20 percent of the total market, or have a 20 percent market share.

Many video game products launch with great enthusiasm and die a quick death such as Sega's GameGear and DreamCast, Atari's Lynx, and Nintendo's Virtual Boy. Video game consoles die quickly when only a limited number of game publishers sign up to supply games for the particular product. Producing video game products is a tough competitive business in a finicky market.

Sony released its first handheld video game player, the PSP (for PlayStation Portable), to go up against the market leader Nintendo's GameBoy, which uses pricey cartridges for games. Instead of pricey cartridges, the PSP plays inexpensive mini disks to bring PlayStation2-quality graphics to the relatively primitive handheld market. When Sony announced the PSP, game publishers raced to get a piece of the action, and Sony had 89 companies contracted to build games within a few weeks. In contrast, when Nokia launched its N-Gage game device, it struggled to land five game publishers. Electronic Arts, the world's biggest game publisher, has declared that the PSP will be the biggest driver of growth in the video game market for the next five years. For a new video game product heading into an uncertain and high-stakes market, that is the ultimate vote of confidence.

Reasons to Increase Market Share

Many organizations seek to increase their market share because many individuals associate market share with profitability. Figure B1.8 indicates the primary reasons organizations seek to increase their market share.

Reasons to Increase Market Share
Economies of scale—An organization can develop a cost advantage by selling additional products or higher volumes.
Sales growth in a stagnant industry—If an industry stops growing, an organization can increase its sales by increasing its market share.
Reputation—A successful organization with a solid reputation can use its clout to its advantage.
Increased bargaining power—Larger organizations have an advantage in negotiating with suppliers and distributors.

FIGURE B1.8
Reasons to Increase Market Share

FIGURE B1.9
Ways to Increase Market Share

Ways to Increase Market Share
Product—An organization can change product attributes to provide more value to the customer. Improving product quality is one example.
Price—An organization can decrease a product's price to increase sales. This strategy will not work if competitors are willing to match discounts.
Place (Distribution)—An organization can add new distribution channels. This allows the organization to increase the size of its market, which should increase sales.
Promotion—An organization can increase spending on product advertising, which should increase sales. This strategy will not work if competitors also increase advertising.

FIGURE B1.10
Reasons Not to Increase Market Share

Reasons Not to Increase Market Share
If an organization is near its production capacity and it experiences an increase in market share, it could cause the organization's supply to fall below its demand. Not being able to deliver products to meet demand could damage the organization's reputation.
Profits could decrease if an organization gains market share by offering deep discounts or by increasing the amount of money it spends on advertising.
If the organization is not prepared to handle the new growth, it could begin to offer shoddy products or less attentive customer service. This could result in the loss of its professional reputation and valuable customers.

Ways to Increase Market Share

A primary way to increase market share is by changing one of the following variables: product, price, place, or promotion (see Figure B1.9). It is common to refer to these four variables as the marketing mix, discussed in detail below.

Reasons Not to Increase Market Share

Surprisingly, it is not always a good idea to increase an organization's market share. Figure B1.10 offers a few reasons increasing an organization's market share can actually decrease an organization's revenues.

Marketing

Marketing is the process associated with promoting the sale of goods or services. The marketing department supports the sales department by creating promotions that help sell the company's products. ***Marketing communications*** seek to build product or service awareness and to educate potential consumers on the product or service.

Jenny Ming, president of Old Navy, a division of Gap Inc., believes that unique marketing ideas for Old Navy's original designs heavily contributed to the success of the $6.5 billion brand. Ideas come from anywhere, and Ming found one of the company's most successful products when she was dropping her daughter off at school. It was pajama day at school, and all of the girls were wearing pajama bottoms with a tank top. Ming began wondering why they even created and sold pajama tops; nobody seemed to wear them. The company, having problems selling pajama sets, quickly introduced "just bottoms," a line of pajama bottoms selling at $15. A full pajama set cost $25. Along with the bottoms, the company offered tank tops in different colors so the customer could mix and match the items. The company built a huge business from the "just bottoms" line. Ming encourages her staff to look for marketing and product opportunities everywhere, even in the most unlikely of places.

MARKETING MIX

The classic components of marketing include the four Ps in the marketing mix: product, price, place, and promotion. The ***marketing mix*** includes the variables that marketing managers can control in order to best satisfy customers in the target market (see Figure B1.11). The organization attempts to generate a positive response in the target market by blending these four marketing mix variables in an optimal manner.

Figure B1.12 summarizes the primary attributes involved with each decision made in the marketing mix.

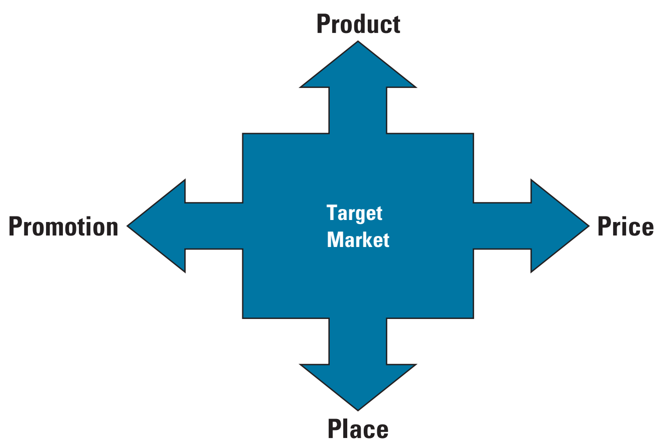


FIGURE B1.11
The Marketing Mix

1.	**Product** — the physical product or service offered to the consumer. Product decisions include function, appearance, packaging, service, warranty, etc.
2.	**Price** — takes into account profit margins and competitor pricing. Pricing includes list price, discounts, financing, and other options such as leasing.
3.	**Place** (distribution) — associated with channels of distribution that serve as the means for getting the product to the target customers. Attributes involved in place decisions include market coverage, channel member selection, logistics, and levels of service.
4.	**Promotion** — related to communication to and selling to potential consumers. An organization can perform a break-even analysis when making promotion decisions. If an organization knows the value of each customer, it can determine whether additional customers are worth the coast of acquisition. Attributes involved in promotion decisions involve advertising, public relations, media types, etc.

FIGURE B1.12
Common Attributes Involved with Each P in the Marketing Mix

Product	Price	Place (Distribution)	Promotion
Quality	Discount	Channel	Advertising
Brand	Financing	Market	Sales
Appearance	Lease	Location	Public relations
Package		Logistics	Marketing message
Function		Service Level	Media type
Warranty			Budget
Service/Support			

CUSTOMER SEGMENTATION

Market segmentation is the division of a market into similar groups of customers. It is not always optimal for an organization to offer the same marketing mix to vastly different customers. Market segmentation makes it possible for organizations to tailor the marketing mix for specific target markets, hence better satisfying its customer needs. Not all attributes of the marketing mix need to be changed for each market segment. For example, one market segment might require a discounted price, while another market segment might require better customer service. An organization uses marketing research, market trends, and managerial judgment when deciding the optimal way to segment a market. Market segmentation typically includes:

- **Geographic segmentation—**based on regional variables such as region, climate, population density, and population growth rate.
- **Demographic segmentation—**based on variables such as age, gender, ethnicity, education, occupation, income, and family status.
- **Psychographic segmentation—**based on variables such as values, attitudes, and lifestyles.
- **Behavioral segmentation—**based on variables such as usage rate, usage patterns, price sensitivity, and brand loyalty.

THE PRODUCT LIFE CYCLE

The ***product life cycle*** includes the four phases a product progresses through during its life cycle including introduction, growth, maturity, and decline. An organization's marketing of a product will change depending on its stage in the product life cycle. An organization can plot a product's profits as a function of the product life cycle (see Figure B1.13).

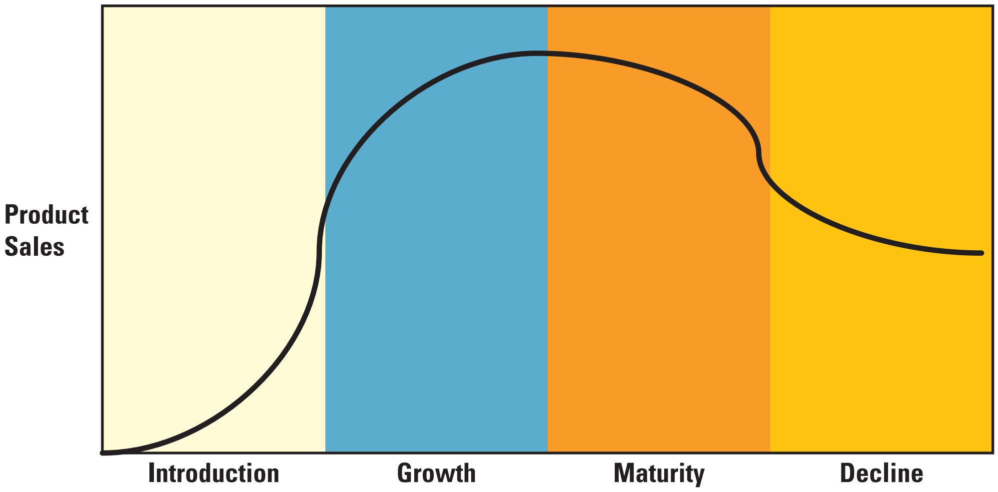
Joanne Bischmann, vice president, Harley-Davidson Inc., is still awed by the lengths customers will go to display their commitment to Harley-Davidson products. Recently, she saw a man who had tattooed a portrait of the four founding fathers along with their 100th anniversary logo on his back. When Bischmann was hired, her manager told her the following, "This will be the best job you're ever going to have because it isn't just about working at a company that makes motorcycles. The founding fathers actually seep out of the walls here." After 15 years with the company, Bischmann agrees with that statement. She always receives calls asking for the Harley-Davidson manual on how to keep customers passionate. Unfortunately, there is no manual. According to Bischmann, Harley-Davidson is a brand that none can own individually; it is more like a tribe, and its members carry on its traditions so it will be here for future generations.

Operations/Production

Operations management (also called ***production management)*** is the management of systems or processes that convert or transform resources (including human resources) into goods and services. The operations department oversees the transformation of input resources (i.e., labor, materials, and machines) into output resources (i.e., products and services). The operations department is critical because it manages the physical processes by which companies take in raw materials, convert them into products, and distribute them to customers. The operations department generally ranks high in the responsibilities of general management.

BUSINESS PROCESS REENGINEERING

A ***business process*** is a standardized set of activities that accomplishes a specific task, such as processing a customer's order. ***Business process reengineering (BPR)*** is the analysis and redesign of workflow within and between enterprises. In business



- **Introduction Stage**—The organization seeks to build product awareness and develop the product's market. The organization will use the marketing mix to help impact the target market. Product branding and quality level are established.
- **Growth Stage**—The organization seeks to build brand preference and increase market share. The organization maintains or increases the quality of the product and might add additional features or better customer service. The organization typically enjoys increases in demand with little competition allowing the price to remain constant.
- **Maturity Stage**—The strong growth in sales diminishes. Competition begins to appear with similar products. The primary objective at this point is to defend market share while maximizing profits. Some companies enhance product features to differentiate the product in the market.
- **Decline Stage**—Sales begin to decline. At this point, the organization has several options. It can maintain the product, possibly rejuvenating it by adding new features and finding new uses. It can reduce costs and continue to offer it, possibly to a loyal niche segment. It can discontinue the product, liquidating remaining inventory or selling it to another firm that is willing to continue the product.

FIGURE B1.13
The Product Life Cycle

process reengineering, the project team starts with a clean sheet of paper and redesigns the process to increase efficiency and effectiveness. The project team does not take anything for granted and questions all the aspects of the process and the business. The reengineering project team obtains dramatic process improvement by redesigning processes that cross departments.

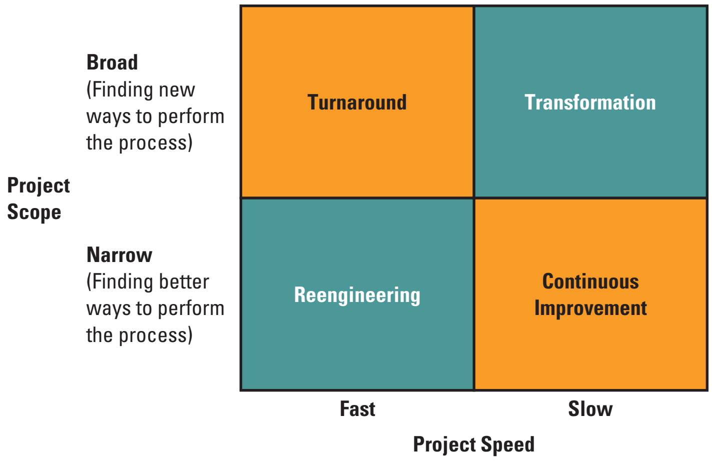
Most of the major opportunities for process improvement exist in cross-departmental processes. Information technology usually plays a key role in process improvement by making possible a radically faster and almost paperless process. However, IT is only an enabling factor. A classic reengineering project example is the accounts payable process at Ford. Through BPR, Ford reduced the number of people required to perform the process from 500 to 125.

TRANSFORMING CORPORATIONS

Complete transformation of an organization, or an entire industry, is the ultimate goal of successful business process reengineering. Figure B1.14 displays a matrix that has project scope on one axis and project speed on the other. For a project with a relatively narrow scope where the speed is fast, reengineering occurs. Fast speed with broad scope may be a turnaround situation requiring downsizing and tough decision making. A project with a relatively slow speed and narrow scope results in continuous improvement. In the upper right-hand corner of Figure B1.14, where the project scope is broad and the time frame for achieving that change is longer, the term *transformation* is appropriate.

FIGURE B1.14

Organizational Transformation through BPR



Progressive Insurance offers a great example of a corporation that transformed its entire industry by reengineering the insurance claims process. Progressive Insurance has seen phenomenal growth in an otherwise staid auto insurance market. Progressive's growth came not through acquisitions or mergers—the stuff that puts CEOs on the front page of *The Wall Street Journal*—but through substantial innovations in everyday operations. Progressive reengineered the insurance claim process. When a customer has an auto accident, Progressive representatives are on hand 24 hours a day to take the call and schedule a claims adjustor. The claims adjustor works out of a mobile van, enabling a nine-hour turnaround rather than the industry standard of 10 to 17 days. The Progressive adjustor prepares an estimate on the spot and will, in most cases, write the customer a check immediately and even offer a ride home.

What provoked this innovation? Progressive says it was the strong connection it has to its customers, its willingness to listen to customers' frustrations, and the common sense to act on those frustrations by changing the core of its business operations. As a result of customer feedback, the company did not merely tweak the details of the claims adjustment process. It dramatically rewrote the process, resulting in significant cost savings for the company. More important, however, the hassle-free claims process keeps customers happy and loyal, reducing the significant burden of constantly replacing lapsed customers with new ones.

Management Information Systems

Information technology (IT) is a field concerned with the use of technology in managing and processing information. Information technology is a broad subject concerned with technology and other aspects of managing and processing information, especially in large organizations. In particular, IT deals with the use of electronic computers and computer software to convert, store, protect, process, transmit, and retrieve information. For that reason, computer professionals are often called IT specialists, and the division that deals with software technology is often called the IT department.

Management information systems is a business function just as marketing, finance, operations, and human resources management are business functions. Formally defined, ***management information systems (MIS)*** is a general name for the business function and academic discipline covering the application of people technologies, and procedures—collectively called information systems—to solve business problems. Other names for MIS include information services (IS), management information services (MIS), or managed service provider (MSP). In business, MIS supports business processes and operations, decision making, and competitive strategies. MIS involves collecting, recording, storing, and basic processing of information including:

- Accounting records such as sales, purchase, investment, and payroll information, processed into financial statements such as income statements, balance sheets, ledgers, management reports, and so on.
- Operations records such as inventory, work-in-process, equipment repair and maintenance, supply chain, and other production/operations information, processed into production schedules, production controllers, inventory systems, and production monitoring systems.
- Human resources records such as personnel, salary, and employment history information, processed into employee expense reports and performance-based reports.
- Marketing records such as customer profiles, customer purchase histories, marketing research, advertising, and other marketing information, processed into advertising reports, marketing plans, and sales activity reports.
- Strategic records such as business intelligence, competitor analysis, industry analysis, corporate objectives, and other strategic information, processed into industry trends reports, market share reports, mission statements, and portfolio models.

The bottom line is that management information systems use all of the above to implement, control, and monitor plans, strategies, tactics, new products, new business models, or new business ventures.

PLUG-IN SUMMARY

The study of business begins with understanding the different types of businesses including a sole proprietorship, partnership, or a corporation. Figure B1.15 highlights seven departments found in a typical business.

All of these departments must be able to execute activities specific to their business function and also be able to work with the other departments to create synergies throughout the entire business.

- **Accounting** provides quantitative information about the finances of the business including recording, measuring, and describing financial information.
- **Finance** deals with the strategic financial issues associated with increasing the value of the business, while observing applicable laws and social responsibilities.
- **Human resources (HR)** includes the policies, plans, and procedures for the effective management of employees (human resources).
- **Sales** is the function of selling a good or service and focuses on increasing customer sales, which increases company revenues.
- **Marketing** is the process associated with promoting the sale of goods or services. The marketing department supports the sales department by creating promotions that help sell the company's products.
- **Operations management** (also called **production management**) is the management of systems or processes that convert or transform resources (including human resources) into goods and services.
- **Management information systems (MIS)** is a general name for the business function and academic discipline covering the application of people technologies, and procedures—collectively called information systems—to solve business problems.

FIGURE B1.15

Common Departments in a Business

KEY TERMS

Accounting, B1.6
Accounting department, B1.5
Asset, B1.6
Balance sheet, B1.6
Bookkeeping, B1.6
Break-even point, B1.8
Business process, B1.14
Business process reengineering (BPR), B1.14
Capital, B1.3
Corporation (also called, organization, enterprise, or business), B1.3
Dividend, B1.7
Expense, B1.6
Finance, B1.8
Financial accounting, B1.6
Financial quarter, B1.7
Financial statement, B1.6
For profit corporation, B1.4
Human resources (HR), B1.8
Income statement (also referred to as earnings report, operating statement, and profit-and-loss (P&L) statement), B1.6
Information technology (IT), B1.16
Liability, B1.6
Limited liability, B1.3
Limited liability corporation (LLC), B1.5
Limited partnership, B1.3
Loss, B1.2
Management information systems (MIS), B1.16
Managerial accounting, B1.6
Marketing, B1.12
Marketing communication, B1.12
Marketing mix, B1.13
Market segmentation, B1.14
Market share, B1.11
Net income, B1.6
Not for profit (or nonprofit) corporation, B1.4
Operations management (also called production management), B1.14
Owner's equity, B1.6
Partnership, B1.3
Partnership agreement, B1.3
Product life cycle, B1.14
Profit, B1.2
Revenue, B1.6
Sales, B1.10
Shareholder, B1.3
Sole proprietorship, B1.3
Solvency, B1.6
Source document, B1.6
Statement of cash flow, B1.7
Statement of owner's equity (also called the statement of retained earnings or equity statement), B1.7
Transaction, B1.6

CLOSING CASE ONE

Battle of the Toys—FAO Schwarz Is Back!

German immigrant Frederick Schwarz established FAO Schwarz, a premier seller of fine toys, in 1862. After moving between several store locations in Manhattan, the growing company settled at 745 Fifth Avenue in 1931. FAO Schwarz soon became a toy institution, despite the impending Depression.

Unfortunately, the New York institution closed its doors in 2004 after its owner, FAO Inc., filed for bankruptcy twice in 2003. The company ran into trouble because it could not compete with the deep discounts offered on toys at chain stores like Wal-Mart and Target. All the stores in the FAO chain were closed.

Some people believe that FAO Schwarz was its own worst enemy. The company sold Sesame Street figures for $9 while the same figure at a discount store went for less than $3.

In 2004, the New York investment firm D. E. Shaw & Co. bought the rights to the FAO Schwarz name and reopened the Manhattan and Las Vegas stores. The grand reopening of the New York store occurred on November 25, 2004, during the Macy's Thanksgiving Day parade. It appears that the company has learned from its previous mistakes and is moving forward with a new business strategy of offering high-end, hard-to-find toys and products along with outstanding customer service.

Jerry Welch, FAO chief executive officer, states the company based its new business strategy on offering customers—local, visitors, and Internet—a unique shopping experience in which they can spend thousands of dollars or just twenty, but still purchase an exclusive item. The store no longer carries any items from top toymakers Hasbro Inc. or Lego. The only toys it carries from Mattel Inc. are Hot Wheels and limited-edition Barbie dolls, starting at $130 for the Bridal Barbie dressed in a Badgley Mischka designer wedding gown and chandelier earrings. A few of the items the store is offering include:

- $20 made-to-order Hot Wheels car that a child can custom design via a computer.
- $50,000 miniature Ferrari with a full leather interior, fiberglass body, three-speed transmission, and working sound system that travels up to 24 kilometers an hour and is not recommended for children six and under.
- $15,000 stuffed elephant.
- $150,000 6.7-meter-long piano keyboard, which premiered in the Tom Hanks movie *Big.*
- Baby dolls that are arranged in incubators and sold by staff wearing nurses' uniforms.

Welch said, "FAO is a 142-year-old brand that, because of our location on Fifth Avenue, people all over the world know. So we start out with great recognition and what we've done here is pull together something that you just can't find anywhere else in the world. Everything here is made by small, unique manufacturers from all over the world." Welch is confident the stores will be richly profitable for its new owners because they have stopped offering mainstream products found in rival stores to generate sales volume. The new owners have returned to a business strategy focusing on quality and exclusivity that were the hallmark of the original store.

The Future of the Toy Store Playing Field

Toys 'R' Us began slashing prices during the 2004 holiday season in a last-ditch effort to fight off intense price competition from big discounters like Wal-Mart and Target. Toys 'R' Us CEO John Eyler stated the company would not be outdone on pricing, during the holiday sales rush, though he cautioned he was not planning to engage in a price war. There have been several reports that the company might leave the toy business to focus on its more profitable Babies 'R' Us unit. Toys 'R' Us lost $25 million for the three months ended in October 2004. The company lost $46 million in the same period the year earlier. The decrease in losses can be attributed to a big cost-cutting effort.

Kurt Barnard of Barnard's *Retail Trend Report* stated that Toys 'R' Us is destined for oblivion—it cannot stand up to the discounters. Toymakers like Mattel and Hasbro, whose profits have also suffered from Wal-Mart's market power, have given Toys 'R' Us a hand by offering it 21 exclusive items not available at other stores.

Toy manufacturers fear that greater monopoly power from Wal-Mart will force them to slash their profit margins. Wal-Mart carries fewer items than toy stores like Toys 'R' Us, which could lead to fewer choices for consumers.

FAO's new owners believe that Wal-Mart cannot compare with the atmosphere now offered at FAO Schwarz, a true toy heaven. The company is hoping that its new business strategy will allow it to move beyond the battle of the toy stores. Toys 'R' Us will need to find new ways to compete with discounters like Wal-Mart and Target.

Questions

1. Why did FAO Inc. have to declare bankruptcy?
2. Describe the issues with FAO's original business model.
3. Identify the toy retailer's new business model. Do you believe it will keep the new company in business? Why or why not?
4. What strategy can Toys 'R' Us follow that will help it compete with big discount chains like Wal-Mart and Target?

CLOSING CASE TWO

	Innovative Managers
Jeffrey Immelt, General Electric (GE)	■ Repositioned GE's portfolio with major acquisitions in health care, entertainment, and commercial finance ■ Created a more diverse, global, and customer-driven culture
Steven Reinemund, PepsiCo	■ Developed strong and diverse leadership that helped PepsiCo tap new markets ■ Attained consistent double-digit growth through product innovation and smart marketing
Steven Spielberg, Jeffrey Katzenberg, and David Geffen, DreamWorks SKG	■ Computer-animated *Shrek 2* set a record with a gross of $437 million ■ IPO pulled in $812 million
Robert Nardelli, Home Depot	■ Turned a $46 billion company focused on big stores into a $70 billion chain with urban, suburban, and international outlets ■ Drive for efficiency, such as centralizing purchasing and investing in technology, pushed margins above 30 percent
John Henry, Boston Red Sox	■ Broke the most fabled curse in sports, when the Boston Red Sox won the team's first World Championship since 1918 ■ Sold out all 81 home games for the first time in team history
Phil Knight, Nike	■ Transformed a volatile, fad-driven marketing and design icon into a more shareholder-friendly company

FIGURE B1.16

Innovative Business Managers

Innovative Business Managers

BusinessWeek magazine recognized several innovative managers who have demonstrated talent, vision, and the ability to identify excellent opportunities (see Figure B1.16).

Jeffrey Immelt, General Electric (GE)

When Jeffrey Immelt took over as CEO of General Electric, he had big shoes to fill. The former CEO, Jack Welch, had left an unprecedented record as one of the top CEOs of all time. Immelt proved his ability to run the company by creating a customer-driven global culture that spawns innovation and embraces technology.

Steven Reinemund, PepsiCo

Steven Reinemund has turned PepsiCo into a $27 billion food and beverage giant. "To be a leader in consumer products, it's critical to have leaders who represent the population we serve," states Reinemund, who created a diverse leadership group that defines the strategic vision for the company. Reinemund also takes a major role in mentoring and teaching his employees and demands that all senior executives do the same. The payoff: consistent double-digit earnings and solid sales at a time when many of the company's staple products—potato chips and soft drinks—are under attack for fears about childhood obesity and health concerns.

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Steven Spielberg, Jeffrey Katzenberg, and David Geffen, DreamWorks

The DreamWorks studio, founded in 1994 by Steven Spielberg, Jeffrey Katzenberg, and David Geffen, suffered through its share of early bombs. Finally, the studio discovered a green ogre named Shrek and quickly became the hottest studio this side of Pixar Animation. DreamWorks Animation turned a $187 million loss in 2003 into a $196 million profit in 2004, with revenues of $1.1 billion. DreamWorks plans to release two animation films per year, each taking almost four years to produce.

Robert Nardelli, Home Depot

Robert Nardelli took several risks when he became CEO of Home Depot. First, he allocated $14 billion into upgrading merchandise, renovating outdated stores, and investing in new technology such as self-checkout lanes and cordless scan guns. Second, Nardelli expanded into Mexico, China, and other regions, tapping the growing homeowner market. Finally, Nardelli bet big on carrying products for aging baby boomers who wanted to spruce up their empty nests. The moves are paying off. The company sits on $3.4 billion in cash. With 2005 revenues headed to $80 billion, Home Depot is the number two U.S. retailer after Wal-Mart.

John Henry, Boston Red Sox

John Henry earned his fortune in the global futures market by developing a proprietary futures-trading system that consistently produced double-digit returns. Henry's new system, Sabermetrics, helped him reverse the most fabled curse in sports history by leading the Boston Red Sox to the team's first World Championship since 1918. Sabermetrics mines baseball statistics to find undervalued players while avoiding long contracts for aging stars whose performance is likely to decline. With the help of Sabermetrics, Henry has built one of the most effective teams in baseball.

Philip Knight, Nike

Philip Knight, who got his start by selling Japanese sneakers from the trunk of his car, built the $12 billion sports behemoth Nike. Knight and his team transformed high-performance sports equipment into high-fashion gear and forever changed the rules of sports marketing with huge endorsement contracts and in-your-face advertising. Then, just as suddenly, Nike lost focus. In early 2000, kids stopped craving the latest sneaker, the company's image took a huge hit from its labor practices, sales slumped, and costs soared.

Thus began Knight's second act. He revamped management and brought in key outsiders to oversee finances and apparel lines. Knight devoted more energy to developing new information systems. Today, Nike's earnings are less volatile and less fad-driven. In 2004, Nike's earnings increased $1 billion.

Questions

1. Choose one of the companies listed above and explain how it has achieved business success.
2. Why is it important for all of DreamWorks' functional business areas to work together? Provide an example of what might happen if the DreamWorks marketing department failed to work with its sales department.
3. Why is marketing important to an organization like the Boston Red Sox? Explain where Major League Baseball is in the product life cycle.
4. Which types of financial statements are most important to Home Depot's business?
5. Identify the marketing mix and why customer segmentation is critical to PepsiCo's business strategy.
6. Explain business process reengineering and how a company like GE can use it to improve operations.

MAKING BUSINESS DECISIONS

1. Setting Up a Business

Your friend, Lindsay Harvey, is going to start her own chocolate shop, called Chocolate-By-Design. Lindsay is an expert candy maker and one of the city's top pastry chefs. Lindsay has come to you for advice on what type of business Chocolate-By-Design should be—a sole proprietorship, partnership, or corporation. Create a report comparing the three different types of businesses, along with your recommendation for Chocolate-By-Design's business structure.

2. Guest Lecturing on Business

As a recent college graduate, your favorite professor, Dr. Henning, has asked you to come back and guest lecture at his introduction to business course. Create a presentation defining the different departments in a typical business, what roles each play, and why it is important that they all work together.

3. Expanding Markets

J. R. Cash created a small business selling handmade cowboy boots, and within a year his business is booming. J. R. currently builds all of the boots in his store and takes orders over the phone and from walk-in customers. There is currently a three-month waiting list for boots. J. R. is not sure how to grow his business and has come to you for advice. Describe the reasons and ways some businesses increase market share and why J. R. might choose not to increase his market share.

4. Segmenting Customers

Due to your vast marketing experience, you have been hired by a new company, Sugar, to perform a strategic analysis on chewing gum. The company wants to understand the many market segments for the different brands, flavors, sizes, and colors of gum. Create an analysis of the different market segments for chewing gum. What market segment would you recommend Sugar pursue?

5. Product Life Cycle

An associate, Carl Grotenhuis, has developed a new brand of laundry detergent called Clean. Carl wants your opinion on his potential to enter and dominate the laundry detergent market. Using the product life cycle create a recommendation for Carl's new product.

6. Redesigning a Business

Tom Walton is the new CEO for Lakeside, a large cereal manufacturing company. Tom's predecessor had run the company for 50 years and did little in terms of process improvement; in fact, his motto was "if it isn't broke, why fix it." Tom wants to take advantage of technology to create new processes for the entire company. He believes that improving operations will increase efficiency and lower costs.

Tom has a major hurdle to overcome before he can begin revamping the company—its employees. Many of the employees have worked at the company for decades and are comfortable with the motto "if it isn't broke, why fix it." Develop a plan Tom can use to communicate to his employees the potential value gained from business process reengineering.

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