Introduction to Business

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Preview Summary Introduction to Business

Dear IBA-student,

Welcome at the Erasmus University Rotterdam! You are now reading the Introduction to Business summary for IBA. SlimStuderen.nl and Capita Selecta summarized all the mandatory literature and articles you need to know for your exam, so that you may study in the best possible way. We would like to wish you good luck in advance with studying!

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Introduction to Business

Course information

The course Introduction to Business covers various aspects of businesses, ranging from globalization and risk management to entrepreneurship and management. The main aim of the course is to familiarize students with basic business vocabulary and key concepts. Furthermore, the shadow assignment will require teams to analyze a chosen company's performance. The assignment is meant to enhance student's understanding of the important concepts and key words by applying the new knowledge in the assignment. The final grade is based on:

- Shadow assignment 30%;
- Closed book written test part 1 (mc questions) 35%;
- Closed book written test part 2 (mc questions) 35%.

The multiple-choice exams each consist of thirty questions with three possible answers and count for 35% of your final grade. Besides this, you can score a high grade for your shadow assignment quite easily if you put some effort into it. This can really help boost your final grade, as it counts for 30% of your final grade. The average for the shadow assignment last year was a 7.6.

There will be 30 questions in total for the first multiple choice exam. The 10 chapters in this booklet are equally important; every chapter covers about 3 questions in the exam. Some shorter chapters might have 2 questions, or longer chapters could have 4 questions, but in most cases, every chapter covers 3 questions.

Tips & Tricks

For this course it is very important that you learn from both the literature and the lectures. Make sure you do study both! The lecturer will give you information that you cannot find in the book, but will be asked for in the exam. This is why attendance at all of the lectures is highly recommended. For the literature part we recommend that you don't underestimate how much it is. Start in time with studying the literature. Also make sure that you understand all of the concepts and pay attention to possible keywords related to the concepts, as that might help you answer some tricky questions. There will probably also be a few questions that ask about the text in detail, so if you are really aiming for a high grade, you should pay attention to the details. In general, the information mentioned in the lecture and given in the PowerPoint slides are most important. This summary will also explain all necessary concepts and terminology. The mid-term requires you to study the lectures and the book mentioned in the course manual. The second written test also requires you to study the strategy textbook. The first round of exams might be quite overwhelming for some of the students, but don't give up if the first test is harder than you thought! You can still do well on the second test and in the shadow assignment.

This summary will discuss the material from the book, combined with the information from the lectures. There are practice questions at the end of each chapter, which can be compared to the questions you will get on your exams. At the end of the booklet you can find the answers to these questions, and a list where you can find all of the terminology, with the corresponding page numbers. Need extra help? In addition to this summary there is an online course by SlimAcademy.nl available to help prepare you for the exam!

Chapter 1: System Theory and Contingency Approach

This chapter examines the concept of conducting business and places the business in its context. Furthermore, the two different approaches to understand this concept are explained.

Business is the organized effort of individuals to produce and provide goods and services to meet the needs of society. Business is a broad concept; it can take the form of profit-making endeavors such as manufacturing or retailing as well as not-for-profit entities such as public institutions.
There are several types of business activities:

- Innovation;
- Operations;
- Marketing;
- Finance and Accounting;
- Human Resource Management.

These are examined in two ways: First, how they interact with each other. Second, how they are shaped and in turn shape the context in which they operate, for example strategic, organizational, environmental or global contexts.

Business Contexts
The *strategic level* includes the set of short-term and long-term objectives of the firm and is formulated by the upper management, giving an overall direction to the organization. Issues concerning the strategic level of a firm include its goals, structure and ownership, and for instance the budget spent on advertising or the range of goods and services offered.

The *organizational level* refers to how the business activities are carried out and divided amongst the companies' employees. The bigger the size of the firm, the more formalized its structure. This level thus also concerns the firm's structure, how its goals are executed, and by who.

The *environmental level* focuses on five factors: economy, technology, state, labour, and cultural and institutional differences. These factors that operate at an environmental level thus include political and legal issues, taxes, labour market structures, technological advances and so on.

The Business in Context model (BIC) includes the three levels described above. All three contexts interact and influence each other and, especially the factors shaping the environmental level of the firm, contribute to the ever-changing phenomenon of **Globalization**.

There are two main ways to approach and understand an organization's structure and sub-systems:

1. **The Systems Approach** focuses mainly on the internal environment and sub-systems of the organization. The differing background of the organizations is not considered, and firms interact with the environment and make changes accordingly. Organizations are analyzed in terms of inputs, processes and outputs, which must be in balance to reach an equilibrium with the environment.

Generally, within any kind of system there will be inputs and outputs:

Inputs	Process	Outputs
• Materials; • Labor; • Methods; • Finance; • Technology; • Information.	• Strategy formulation; • Innovation; • Operations; • Marketing; • HRM; • Accounting.	• Goods; • Services; • Profit; • Information; • Waste; • Job (dis)satisfaction; • Economic growth.

2. **The Contingency Approach** focuses on the external environment of an organization. The approach emphasizes the impact of environmental changes and pressures on the organization's design and management style. Business activities and strategic decisions are therefore the result of adaptation to a firm's environment.

This approach was popularized by Lawrence and Lorsch in 1967 showing how organizational arrangements are products of the hap-hazard environmental coordinates. They stated that different environments will consequently produce different organizations from the basic material and that contingency planning was meant to keep track of all kinds of fortune and misfortune. It is a prerequisite for risk management.

Generally, contingency planning can be defined as managing the risk of something not happening. Referring to Aristotle, contingency is the contradiction of a necessity, however possibility and necessity are not in contradiction. "Contingency is the possibility that something is not the case, which is incompatible with its being necessary". An example is the novel "Black Swan ", Cf. Taleb, 1991, which talks about the impact of the highly improbable.

Similarities of the two approaches

- Deal with organizations working with elements of the environment and their adaptations;
- Focus on limited range of environmental variables and deterministic approach;
- Ignore influence of organization on environment and behavior of management/workforce.

Technology

Technology plays a vital role in shaping the products and processes firms use, structure of the organization, communication between workers, and also individual job satisfaction. Technology should be adapted and incorporated into business operations in order to use it as a competitive advantage. The relationship between technology and business is vast due to its connections with other variables such as size, management, economic/social change, available finance, industrial relations, state and culture.

Nevertheless, two stances about technology are opposed. The first, supported by Woodward, suggests that technology has the upper hand over a business manager and depicts technology as a determining force. The second addresses the other factors that can have a determining influence, such as the size of a company.

To a further extent, technology can also be regarded as the means used by managers to respond to other external challenges such as the necessity to increase productivity.

Francis Bacon (1561-1626)
He was a philosopher and the "founder" of empiricism. He challenged science vs religion and posed the phrase "knowledge is power". In this "*Novum Organum*", he questioned how religiously received opinions distort people's minds like idols. Four idols of the human mind (idola mentis) are:

- Idols of the "T*ribe*": Ignoring the fallibility of human knowledge (e.g. no one is perfect);
- Idols of the "*Cave*": Errors people pick up via experiences and education (e.g. bad parenting);
- Idols of the "*Market*": Following fads & fashions because of seductive language (e.g. weasel words);
- Idols of the "*Theatre*": Prejudices rooted in religious and philosophical dogma (e.g. priests' opinions).

Francis Bacon supported scientific methods that are evaluated through *observation* and *critical thinking* to untie people from these errors. People should emancipate from errors and be suspicious to the conservative powers.

SlimStuderen.nl Check!
Try to remember the terminology. In some questions they make up new terms in order to confuse you. Try to remember what you studied and do not panic if you see a term that you have not seen before. Stay calm and think of the terms they use in the book to describe certain concepts.

Practice Questions

Practice question 1
Which level refers to how the business activities are carried out and divided amongst the companies' employees?

A. The organizational level
B. The environmental level
C. The strategic level

Practice question 2
Which approach focuses on the external environment of an organization?

A. The contingency approach
B. The systems approach
C. The strategic approach

Practice question 3
Which level gives the overall direction of the firms and the objectives of the organizations?

A. The organizational level
B. The environmental level
C. The strategic level

Practice question 4
Which of the following statements is correct?

A. The contingency approach takes the effect organizations have on their environment into account, the systems approach does not
B. The systems approach and the contingency approach both look at an organization as a product of their external environment
C. Contingency planning describes what organizations plan to do in order to influence their external environment in case of a highly improbable event

SlimStuderen.nl Check!
Sometimes you are not sure which of the answers is correct. In that case, try to find keywords that may determine whether a question is right or wrong. Make sure to read every part of the statement to spot things that might make it incorrect. If you are not sure which to choose, try to choose the one that seems <u>most</u> correct to you.

Chapter 2: Globalization, Business Cooperation and Integration

This chapter focuses on the beginnings and the consequences of globalization on business. Globalization brings many opportunities of expansion for businesses. All of these cooperations and integrations are explained as well.

Globalization

Globalization is the global circulation of goods, services and capital, but also information, ideas and people. It is a fundamental change where national boundaries become irrelevant. It is a process in which the world is converging economically, politically and culturally.

- *Economic* – production of goods and services for global markets, use of labor in different locations, use of global sources for raw materials;
- *Cultural* – exchange of culture across globe due to communication;
- *Political* – activities of supranational groups such as UN and EU.

Globalization in an Environmental Context

- World economy linked through global markets;
- Increased trade (especially in MNCs);
- Nation states join trade and defense alliances;
- Quick technology and information transfer (through the Internet);
- Mixing of cultures.

Globalization in an Organizational Context

- Ownership patterns are more complex due to cross-border acquisitions and joint ventures, and the emergence of TNCs;
- Results in (dramatic) changes for smaller businesses;
- New structures and cultures integrated to adapt to global changes.

How Globalization Impacted Strategy

- Ease of technology transfer – impacts on innovation, R&D and production processes;
- Marketing on a global scale;
- Devising policies for staff operating globally;
- Finance becomes a global resource – adapt to certain accounting procedures.

According to Jan Aart Scholte, Globalization is formed by 5 elements:

- **Internationalization –** increased international trade leading to the development of global networks.
- **Liberalization –** creating free markets, making information widely available.
- **Universalization –** process of standardization due to regulatory structures.
- **Westernization –** dominance of the western values and cultures with a prominent influence from the USA.
- **Deterritorialization –** less importance given to national boundaries. It is the distinctive feature of globalization as opposed to previous phenomena.

Start of Globalization

There are differing views on the causes behind the rise of globalization over time. According to *Manuel Castells*, globalization arose through the development and advances of communication and travel. Globalization thus started in the 19th Century, through significant developments in industrialization and trade – mainly in capitalist economies.

The growth in capitalist economies is attributed to **accumulation** and **commodification**.

- **Growth in capitalist economies** – accumulation (Marx). For example, in competitive markets, firms must increase scale of production to accumulate profit. This encourages firms to look for new markets outside of their national boundaries to increase sales and profits.
- **Growth in capitalist economies** – commodification (a broadening scale of consumption) is also linked to capitalism. This involves widening the scale of consumption and increasing accumulation simultaneously;

As a consequence of accumulation and commodification, firms seek to develop goods and services on global markets and achieve economies of scale. This combined effort has therefore led to the start globalization as a global phenomenon.

Causes & Drivers of Globalization

- Importance of rational knowledge – science, technology, solving problems;
- Growth of trade which has led to increased linkages between national economies;
- Increase in foreign direct investment (FDI) – leads to growth of MNCs;
- Multinational corporations – spread of technology and ideas, joining processes and management practices;
- Costs –economies of scale, search for low costs of raw materials (interest in the countries that offer this comparative advantage) reinvested in R&D at a later stage, competition;
- Technological innovations – easier movement and more flow of people, money, goods, information and ideas;
- Changing world politics – unity of new markets, increased trade, increased MNCs and FDI;
- Changing markets – markets tend to have similar needs that can be fulfilled by the same products worldwide, new markets such as the Asian Tigers (Hong Kong, South Korea, Taiwan, Singapore) now shape the distribution of good;
- Regulations – standardization and integration through governmental alliances and trade blocs such as the EU, NAFTA or ASEAN.

Global Markets

Levitt (1983) believes that cultural differences was an exaggerated barrier and that, despite the differences, many products have gone global. Due to the rise of global markets, the products had become more technical and competition has increased widely. This increases product development costs which can only be recovered through economies of scale, standardized global products and larger markets. The demand for these global products is high due to low costs of communication and travel.

However, there are still political (import quotas, taxes), economic (affordability), and cultural (suiting to local tastes) barriers. It is not just goods being marketed and sold globally, financial markets are also interconnected through foreign exchange, shares, insurances, stock exchanges, and cross-border transactions.

Global Production
They integrate production across many locations. Companies tend to source employees from low-wage economies. Such globally produced goods include components from several parts of the worlds assembled by the manufacturer at different stages of the production process.

Outsourcing and off-shoring

- **Outsourcing** is when a firm delegates another company to carry out part of the process in the form of a contract. This allows the firm to focus on their core activities to ensure prime outcomes for their customers. This is very common in automotive and computer industries. Outsourcing usually occurs between firms located in the same country.
- **Off-shoring** is when the business activities and processes are moved to another country. It involves equity in another country and is based on hierarchy.
- **Offshore outsourcing** is when firm moves activities to another country and also contracts the activity to another company. These have created offshore centers, mergers and acquisitions, joint ventures, strategic alliances, and sub-contracted operations. The driving factors for the development of these forms of organizations are increased competition, cost reduction, lower shipping costs, cheaper and faster telecommunications.

The terms home firm and home country refer to the MNC's country of origin; host firm and host country are used for the new location.

Global factory
Includes activities and network of a global firm that takes care of servicing production, distribution, marketing, design, branding and innovation. A global factory is where components are made by different firms around the world and then brought together for final assembly – known as the fine slicing of production process and as a modular supply chain. It is driven by the need to reduce costs.

Some key features of a global factory:

- Technology – mass production of standardized products to ensure same quality, enabled the manufacturer of components by companies excluded from the design and development of a product;
- ICT – information and communications technology allow for low global communication costs for information flows and effective control;
- Simpler access to massive amounts of (unskilled or semi-skilled) cheap labor.

Modular system of production is when the contract firms must be flexible to deal with the change in demand and still continue to operate at low costs to gain the contract. The global factory also extends to the service sector in areas such as accounting and consulting.

“I WANT HIGHER GRADES”

“I WANT TO BE BETTER PREPARED FOR MY EXAMS”

“THIS YEAR I WANT TO OBTAIN ALL MY CREDITS”

GOING FOR A DRINK RELAXING {LECTURES}
DOING AN INTERNSHIP CLUBBING
BEING ONLINE {STUDYING} DOING SPORTS
COMMISSIONS CHATTING CHILLING
{READING} FACEBOOK TRAVELLING
BIKING LISTENING TO MUSIC
WATCHING A MOVIE HAVING LUNCH SLEEPING IN
TEAMWORK TWEETING
{MAKING PLANS} GAMING SIDEJOB
CHOOSING A MINOR SHOPPING
GRABBING A COFFEE {LEARNING} LINKEDINNING
PARTYING {GRADUATING}

Global Value Chains

Global value chain represents the build-up of value in a supply chain that consists of a number of international partners. This allowed for increased international trade of components instead of manufactured goods.

Two types of global value chains:

- **Producer-driven chains** – when the original designer of a product arranges production, controls technologies and supervises the manufacture and assembly of components across several sub-contractor firms.
- **Buyer-driven chains** - companies set up chains, in low wage economies, to produce low-cost, unsophisticated, goods that are later branded. This usually happens is large retail operations, large clothing and footwear manufacturers.

Supply chains can be governed by markets or by hierarchies, they can be identified:

- **Modular chains -** involves range of suppliers that produce components as ordered by the lead firm.
- **Captive chains -** small supplies depend on powerful large buyers.
- **Relational chains –** main firms and suppliers have a close relationship that is based on trust and experience of working together. This creates synergy as firms learn to become mutually flexible. This often has beneficial outcomes.

The Multinational Corporation

As we have seen until now, **multinational corporations** are a coordinated system of cross-border value generating activities. The rise of MNCs through globalization can be explained by many factors. One of these is the need for organizations to protect themselves from cyclical problems of economies, especially in their home-country. Global sales allow firms to take advantage of international markets when home markets suffer negative economic fluctuations.

MNCs also benefit from access to raw materials and cheap resources around the world, especially in low-wage economies. This allows for a significant reduction in costs and the possibility for firms to achieve economies of scale, when marginal costs decrease as production goes up.

The modes of entry of organizations in other markets and countries globally are also a determinant of costs, and thus production. MNCs can enter foreign markets through:

- **Exporting** – the first stage of a firm's international growth. It is the easiest mode for organizations to sell abroad as it is characterized by low costs and low risk, but can lead to issues regarding forms of tariffs and quotas.
- **Licensing** – when a firm permits another company overseas to produce a good or service for a fee. This allows to avoid import tariffs and it is relatively low-risk. Problems may arise if licensees become independent, share restricted information and knowledge.
- **Franchising** – similar to licensing, but the overseas firms produce the entire company's range of products. This avoids tariffs but requires a rigorous quality control by the MNC. McDonald's is a clear example of franchising.
- **Offshore outsourcing** – mainly used for cost efficiency of production. It consists of outsourcing parts of a company's production process to firms overseas.
- **Joint ventures** – when firms from different home-countries come together to create a new firm. It involves shared ownership of capital and facilities, thus requiring restrictive contract terms. Its benefits for the firms involved are shared technology, marketing and management expertise as well as access to new markets. However, joint ventures can also create organizational complexities, increasing costs and reducing flexibility. A successful joint venture depends on the strategic fit between the parties involved, which is whether the firms in the venture have complementary core competencies. Other determinants of a successful joint venture are compatibility, commitment and the control among the firms involved.
- **Wholly-owned subsidiaries** – it occurs through the acquisition of a foreign firm or by establishing a Greenfield site operation (where the parent company builds its operations abroad from the ground up). It is a form of foreign direct investment (FDI) that is both risky and costly.

Multinational corporations also tend to form strategic alliances, which are long-term partnerships between two or more companies to give both companies a competitive advantage. In contrast with joint ventures, it is not necessary to share costs, risks, management or profits.

Strategic Alliances and Joint Ventures

These have begun to emerge due to globalization, increased competition, and attractiveness of emerging markets. In advanced economies, this is due to declining growth rates, increasing costs of home operations such as labor and R&D. This is a fast and effective way to enter a new market, a cost-effective way of product development and distribution.

Strategic Alliance occurs when two companies agree to work together on a specific project or share facilities. For example, there are many alliances in the airline industry, such as the Star Alliance and the One World Alliance. This helps customers with single booking, arranging ticketing and baggage handling across routes. A strategic alliance is not as contractual a relationship as a joint venture.

Joint ventures

Joint ventures involve an element of shared ownership and restrictive contract terms.

Reasons for growth of joint ventures:	**Problems of joint ventures:**
Access to specific core competencies – use of knowledge, skills and technology as a competitive advantage;	Organizational complexities resulting in increased costs, only improved by a clear strategic fit;
Adjust to local market needs and achieve a better understanding of the market in order to increase market share;	Capability – skills/assets firm can bring to the joint venture need to live up to the other parties' expectations;
Risk reduction – international joint ventures can reduce risk by using local knowledge and networks;	Problems of compatibility in terms of organizational culture, management style or administrative procedures for instance;
Need for survival within the context of harsh global competition;	Commitment does not always last enough to ensure the success of the joint venture;
Synergy – creating beneficial outcomes by working together;	Issue of control and dominance from one of the parties involved;
Cost reduction;	Measuring performance outcomes – there are different reasons as to why firms create joint ventures.
Market growth and new market entry;	
Increased control of the supply chain;	
Technology transfer.	

Mergers and Integration

- **Horizontal mergers** are between firms producing similar products in similar markets. They reduce the number of firms in the industry, which reduces competition. An example is American Airlines and US Airways which both provide customers to fly to the United States and around the globe.
- **Vertical mergers** are between firms that work at different but related levels in production and marketing of the product. An example is Oracle acquiring BlueKai, which was a small company that developed a data management software. Oracle purchased BlueKai and utilized their management software.
- **Conglomerate mergers** are between firms in completely different industries. For instance, Berkshire Hathaway purchased Duracell because of its great financial potential.

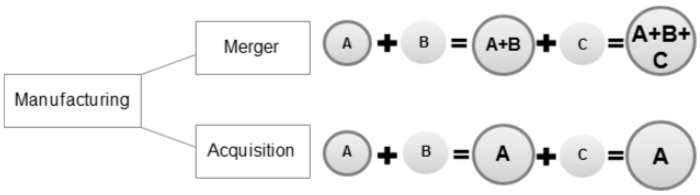

Figure 1: Difference between Mergers and Acquisition (*Source: Strategic Management Insight)*

Practice Questions

Practice question 1
Some firms establish a subsidiary in another country. This is an example of:

A. Licensing
B. A joint venture
C. Foreign direct investment

Practice question 2
When a steel manufacturer takes over an iron ore mine, what kind of acquisition is this?

A. Vertical
B. Horizontal
C. Conglomerate

Practice question 3
Which one is the first stage of a company's international growth?

A. Licensing
B. Foreign direct investment
C. Exporting

Practice question 4
Which of the following covers the place where components are made by different firms around the world and then brought together for final assembly?

A. Global value chain
B. Global factory
C. Modular chains

Practice question 5
Company XYZ, located in Germany, produces mobile phones. They decided that it would be cheaper for them to let the screens for these phones be produced by Company ABC in Japan. What is this an example of?

A. Outsourcing
B. Off-shoring
C. Offshore outsourcing

Answers to Practice questions

Chapter 1

Practice question 1

The answer is A.
The Strategic level concerns the company's goals, the Environmental level looks at a company's external factors; the Organizational level refers to how the business activities are carried out and divided amongst the companies' employees (p. 3).

Practice question 2

The answer is A.
The Systems Approach mainly focusses on the internal environment of a company. The Contingency Approach focusses on the external elements. The Strategic Approach is not and approach discussed in the course material and is included in this question in order to confuse you (p. 3-4).

Practice question 3

The answer is C.
The Organizational level refers to how business activities are carried out. The Environmental level looks at a company's external factors. The Strategic level determines the overall direction and objectives of an organization (p. 3).

Practice question 4

The answer is B.
Both approaches do not take the effect that organizations have on their environment into account. They only deal with the effect of the external environment on the organizations. Therefore, A is incorrect. Contingency planning describes what organizations plan to do <u>within their own organizations</u> in case of improbable events. The keywords here were 'external environment'. C is thus incorrect. The right answer is B, because both approaches look at the reaction of organizations to their external environment (p. 3-4).

Chapter 2

Practice question 1

The answer is C.
In the case of licensing, another company would get the rights of producing the same product as the first company. The answer is therefore not A. In the case of a joint venture, two existing companies would come together, so the answer is not B. A subsidiary is a 'daughter company', wholly owned by the 'parent company'. In this case it is an example of Foreign Direct Investment, because the companies directly invest part of their business in another country (p. 10-11).

Practice question 2

The answer is A.
The company first only manufactures steel, by taking over an iron ore mine, the company expands its operations to a different but related level in the supply chain. This is therefore a vertical acquisition (p.12).

Practice question 3

The answer is C.
Exporting is the activity with the lowest cost and lowest risk. It is the easiest activity for any company to start with. This is therefore the first stage of a company's international growth (p. 10-11).

Practice question 4

The answer is B.
A global value chain represents the build-up of value in a supply chain with a number of international partners. A modular chain involves a range of suppliers that produce components ordered by the lead firm. Global factory is the name of the concept where components are made by different firms around the world and then brought together. The answer is therefore B (p.10).

Practice question 5

The answer is C.
The firm is moving the activity of screen production to another country, but is also contracting another company for this. This is thus an example of offshore outsourcing.

Terminology

Term	Pagenumbers
Accumulation	8
Buyer-driven chains	10
Captive chains	10
Commodification	8
Conglomerate mergers/integration	12
Deterritorialization	7
Exporting	10
Franchising	10
Global value chain	10
Globalization	3, 7, 8
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Epilogue

Yesss you did it! You've read the whole summary!

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