BUSINESS

The Key Concepts

Mark Vernon

London and New York

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The Key Concepts

Here is a practical and accessible guide to the essentials of business. This book provides everything you need to know about the key concepts and terms, from accountability to zero-sum game. Subject areas include management, economics and finance, marketing, organizational behaviour and operations. Each entry is written in a clear style to make business intelligible.

- Combines detail and accessibility.
- Considers new developments in business, notably e-business and contemporary business ethics.
- Covers established subjects, taking an international and strategic perspective that balances theory and practice.
- Suggests specific further reading for many concepts and also includes an extensive bibliography.

Whether you're already in business and you could do with a handy reference guide, or you're a student needing an introduction to the fundamentals, *Business: The Key Concepts* is the perfect companion.

Mark Vernon writes on business for the *Financial Times*. He also contributes articles on the subject for a wide range of other publications on both sides of the Atlantic. He holds degrees from the universities of Oxford and Durham and is currently undertaking research at Warwick University.

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PREFACE

This book is a resource. It provides an explanation and exploration of the key concepts in the study of business. The list includes subjects from the areas of management, marketing, finance, economics, organizational behaviour and operations. Care has been taken to present an international viewpoint, to consider contemporary perspectives on business such as strategic approaches, and to balance theory and practice. The exciting though often hyped developments associated with e-business and ethical business are also assessed. Throughout, I have endeavoured to apply the ethic of transparency to the business of writing, that is to provide clarity.

The book is written to be used. Three groups of people in particular have been held in mind. The first are students of business, whether beginners looking for an introduction or those who are more advanced and need a resource to extend their studies. The second are practitioners of business who could do either with a desktop reference book to help them understand their work more thoroughly, or simply with a resource to provide them with material, say for that presentation next week. The third group of people are interested general readers who hear words like 'innovation' or phrases like 'neoclassical economics' bandied around and wonder quite what is meant by them.

The entries in this book cover the subjects that would be included in most business studies or MBA courses. When a subject is fundamental the entry aims to explain it. When a subject is more controversial the entry provides a critique and balanced viewpoint. Each entry begins with a definition, followed by a description and discussion of the concept that is designed both to ground the subject firmly and outline avenues in which it is being developed.

Entries are of different lengths, reflecting the relative importance of the subject. For example, utility has a short entry since whilst it is a word employed in business studies it is also more generally used. Alternatively, zero-based budgeting has a short entry since, in terms of this book, it is a secondary, if important, subject in relation to accounting.

Long entries vary in aim to ensure that as many subjects, and angles on subjects, as possible are covered. For example, the marketing entry provides a high-level introduction to the many subjects that fall under that heading. These can be followed up in other parts of the book. Alternatively, the management entry offers a discussion of the study of management rather than management *per se*, since that seemed a more useful thing to do. Again, areas of management are discussed thoroughly under separate headings. Or again, the long entry under technology discusses the close relationship between technological advances and economic advances; it is therefore different from the long entry under information and communications technology which takes more of a technical slant; this is in turn different from the long entry under e-business, which addresses the question of what difference electronic networks make to business and how they might be used.

Every entry ends with at least one of two notes. The first, 'See also', points to other related entries in the book which either develop the subject further or point to entries that have a lateral but interesting link with it. The second, 'Further reading', suggests relevant material from the bibliography. With these two pointers, the book aims to help the reader in their ongoing exploration of business concepts.

The detailed index provides another starting point. In particular it will help readers find hundreds of additional subjects that are not listed among the entries. For example, the finance entry contains discussions of payback period and of net present value that are listed in the index.

The bibliography is extensive. It includes a long list of important business books published in the last three years, key reference books in the areas of management, business and economics, and classic texts, from historic thinkers as well as modern exponents of business. Many of them are referenced at the end of the entries, but the bibliography also provides suggestions for further reading. The idea is that in it, and indeed in the book as a whole, readers will find rich resources to continue their study of business.

ACKNOWLEDGEMENTS

I am indebted to the British Library for providing me with a place in which to write and many of the materials with which to research the book. I would also like to thank Stuart Draper, who first introduced business to me, and Craig Mackenzie, with whom I have enjoyed long hours of discussion about the subject since.

Mark Vernon
London
January 2001

ACCOUNTABILITY

The obligation placed on employees and organizations to be answerable for their actions.

In practice, the term denotes a framework of responsibilities covering various decisions and actions within which individuals or groups work. The goal is to ensure that standards, methods and timeframes are adhered to.

Accountability finds its roots in classical management theory, with its militaristic belief in lines of command and specialization that governs the division of labour. However, the concept has been modernized so that accountable management today is a practice that seeks to manage by holding employees to performance measures or objectives, agreed wherever possible with the individuals concerned. Cost and profit centres are closely associated with this style of management – the establishment of units within the organization based on function or location for which costs or profits can be reliably calculated and, therefore, controlled. Shareholders and other third parties are also developing means of holding firms to account, often over ethical concerns.

See also: **Audit, Ethics, Performance**

Further reading: Klatt *et al.*, 1999

ACCOUNTING

The discipline that provides information about a business based on financial data.

Accounting information can be used by anyone making decisions about the organization or their relationship to the business. Accounting is a massive subject area embracing a variety of methods that have a profound impact upon the way a business is viewed. Here, the fundamental principles are reviewed along with some pointers as to how the subject is currently evolving.

The results of accounting procedures can range from a simple balance sheet to a voluminous record of a corporation's entire commercial activity, but the discipline as a whole can be broken down into two broad areas. The first is financial accounting, the preparation of reports for shareholders, tax authorities and business reports. Accounts must therefore be intelligible to these third parties according to rules that might be enforced by law. The second is managerial accounting, the use of financial data within an organization to assist in decision making and driving profit and growth.

Financial accounting varies according to legal, economic and social context. This can present a number of problems to businesses. For example, accounting principles as Americans put it, or accounting practices for the UK, differ dramatically. In the UK, four principles are basic: the going concern principle, that is a company is at least initially assumed to be viable; the self-explanatory principle of prudence; the matching principle which says that records are entered in the period in which they arise not when actually transacted; and the principle of consistency which advises adherence to precedent.

Accounting standards are agreed by national professional associations to assist in the auditing process. However, these give rise to another source of variation: standards are legally enforceable in Canada and often in the US, but are voluntary in the UK.

Accounting for goodwill and foreign currency exchanges also contributes to diverse practices. Hence there are many initiatives to promote accounting harmonization. For example, it is an important driver in European Economic and Monetary Union.

Managerial accounting originates in the need to control costs. It is not necessarily subject to external rules, and variations in practice are common, typically due to inherited anomalies, although best practices are often deployed. Models such as cost volume profit analysis (CVP), that calculates financial economies of scale, are fundamental. More sophisticated tools, such as activity based costing (ABC), seek to enhance this basic information. Others deal with less tangible factors that demand a degree of personal judgement as well as objective standards. For example, cost-benefit analysis assesses the enhancement of a product or service accrued from a particular cost. Firms also implement accounting software tools, such as Enterprise Resource Planning (ERP), to overcome gaps in corporate knowledge.

The central accounting discipline has sprouted a number of branches to meet particular needs. For example, cash flow accounting provides an alternative to transaction analysis by calculating the difference between a company's cash outlays and income over the accounting period. Inflation accounting incorporates measures that are able to deal more meaningfully with businesses working in areas in which monetary values fluctuate significantly. Infamously, creative accounting uses techniques to improve the financial profile of the firm (though whenever even two conservative accountants are looking at the same data, at least three different reports will result).

Today, the academic study of accounting embraces a number of tensions, such as the arguments between those who advocate the importance of value in accounting and those who prefer to stick to hard costs. Accounting practices are also likely to continue to develop as factors such as the demands of international capital markets grow. Further, as the firm's relationship with its banks evolves, accounting for financial products such as swaps and derivatives will increasingly be taken in-house, making the accountant's tasks more complex.

See also: **Activity-based costing, Audit, Cash, Finance, Foreign exchange risk, Goodwill, Income statement, Inflation accounting, Opportunity cost, Transfer pricing, Zero-based budgeting**

Further reading: Bishop *et al.*, 1999; Kaplan and Atkinson, 1998; Jagolinzer, 2000; Rashad Abdel-Khalik, 1998; A. Thomas, 1999

ACCULTURATION

The process whereby a foreign culture is assimilated without losing the benefits of the original or the other.

In international business, acculturation is a tricky issue. Informal management styles in Silicon Valley, for example, do not work well with Japan's preference for extensive deliberation. Alternatively, global labour markets demand a greater understanding of the stresses and strains on employees negotiating different cultures. The effectiveness of a workforce can be severely impaired if cultural preferences are ignored.

A further issue concerns that of cross-cultural marketing. There are relatively few genuinely global brands, with most varying according to locale. Occasionally, things go very wrong. For example, dogs associated with toilet paper works well in the West, but not in the Middle East, where the animals are regarded as dirty.

See also: **Culture, Geocentricism, Joint venture**

Further reading: Beechler and Stucker, 1998; Morosini, 1998

ACTIVISM

The initiatives of employees, shareholders, stakeholders or pressure groups to influence the decisions or actions of a company.

The demonstrations of activists protesting at the meetings of the World Bank and IMF have recently stolen the headlines. Powered by communications technology, these various groups are highly organized and arguably effective at raising their concerns. However, this kind of very visible activism is only one, contested, way in which people try to influence the operation of businesses.

For example, shareholder activism has long been a feature of American corporate life. Mackenzie describes it as shareholder action, a loose term that covers attempts to influence corporate decision making through the shareholder process. It can cover action by individuals, small campaigning groups, large national pressure groups, and institutional investors like pension funds. This kind of shareholder action is different from the traditional concerns of shareholders with dividend payments. It refers to attempts to encourage a company to think about a range of social and ethical policy questions.

Shareholder action in the pursuit of social interests has become increasingly common in the last two decades, particularly in the US. Today, several hundred companies face ethically motivated shareholder action campaigns at any one time. While the overwhelming majority of these campaigns take place in America, a growing number of companies in other countries have faced pressure from shareholder activists too. Institutional investors that are increasingly interested in ethical fund management, companies that want to be seen to be more accountable for their actions, and other kinds of activism, will ensure that shareholder action is a trend set to grow.

See also: **Environmental audit, Ethics, Social audit, Stakeholder**

Further reading: Mackenzie, 1993; Pringle and Thompson, 1999; Weinreich, 1999

ACTIVITY-BASED COSTING

An accounting method that aims to assess and include the real costs of processes, called activities, in the production of products, called cost objects.

Activity-based costing is the most important of the new accounting techniques that have emerged since the early 1980s. It developed to rectify faults with traditional cost management solutions. In particular, ABC allows the costs of products to be assessed more clearly in relation to identifying profits and economic break-even points, as well as with other managerial purposes such as improving strategic decision making and implementing business plans. ABC lends itself well to situations in which overheads are high, where accounting errors are sensitive or competition is high, and where cost objects themselves are complex.

The total cost of a product is the sum of its direct cost, such as labour and materials, and associated overheads. It is this second element that ABC addresses in particular. Traditional cost accounting arbitrarily allocates overhead costs by assuming that they can be calculated according to volume-based measures, such as machine time and labour hours. ABC focuses on tracing expenses accrued by objects and treating them as direct costs.

Understanding the relationship between cost objects, activities associated with them and the resources they consume is central. ABC requires five steps: identification of activities, determination of cost of activities, determination of cost drivers, collation of activity data and calculation of product cost.

The adoption of ABC by organizations varies, although why firms that would otherwise apparently benefit from the virtues of ABC do not adopt its practices is an open question.

See also: **Accounting**

Further reading: Brimson, 1999; Forrest, 1996; Innes and Mitchell, 1998; Turney, 1996

ADAPTABILITY

The flexibility of a company's aims.

Adaptability is important to business in certain specific senses. An adaptive strategy is one in which negotiation and compromise characterize the achievement of goals that are themselves adaptable. This mode of operation is typically suited to public sector or charitable organizations. However, adaptability is increasingly recognized as a valuable quality even for organizations used to fixed targets and strict aims.

A second less significant application of adaptability refers to employees' ability to cope with change, and is deployed in the screening of employees for work abroad. Tests include assessing the ability to handle stress and the ability to make decisions on limited knowledge.

See also: **Aptitude test, Mission statement**

Further reading: Birkinshaw and Hagström, 2000

ADHOCRACY

The type of organization associated with an open-ended style of decision making.

An adhocratic structure seeks to allow all staff in the organization to work together across traditional divides for the achievement of the goals of the company. The reason behind such a complex environment is to produce the dynamism necessary to make decisions that face high degrees of uncertainty or chance. For example, administrative staff might have insights on an issue that production managers alone would overlook. Alternatively, an innovative organization might adopt adhocratic methods so that good ideas can surface from a variety of sources.

Garbage can models of decision making are a famous variation. Here, the value of chaos within the organization is recognized, with management's task being to steer the creativity that results.

See also: **Creativity, Innovation**

Further reading: Carter, 1999; Stredwick and Ellis, 1998; Syrett and Lamminman, 1998

ADVERTISING

The paid-for use of mass media to promote goods and services to influence customers.

Although it should immediately be added that an accurate definition of advertising, with its assumptions about the use of media, and the rationale and effectiveness of the advertisement, is notoriously hard to come by. There are a number of reasons for this, reflecting the complexity of the subject.

For example, advertising is not solely concerned with selling products. This has been the argument of the tobacco industry as it fights in various parts of the world to maintain its right to advertise: here advertisements are designed to maintain loyalty to brands and win smokers from other brands, not to sell cigarettes *per se*. Advertisements are also designed to establish legitimacy or significance, and to animate a company, service or product.

Another important point is that whilst advertisers use mass media, they do not in general seek to reach mass audiences. Advertisements are generally targeted at small groups of individuals who are susceptible to the message they carry.

The origins of modern advertising lie in the Industrial Revolution and the mass production of goods. The problem manufacturers had was to find or create new mass markets, and then manage them using techniques such as segmentation. Mass media provided the means and the development of brands was perceived as achieving the ends; indeed, some would argue that it was advertising that created consumer culture.

Advertising contributes to the overall marketing mix, although how much depends on who you ask. One hundred years ago, the British advertising agent S. H. Benson wrote, 'the results of advertising are not discernible', and the study of the interaction of audiences and advertisements has been extensive and contested ever since. Academics contribute a theoretical perspective using disciplines such as semiotics. Practitioners, especially media buyers, constantly struggle to quantify the effectiveness of advertisements. Pre-testing with focus groups and post-evaluation by polling are common methods. Reach, frequency and impact are the variables that are taken into account. Effectiveness is a particularly current critical issue for new media, the aim being to justify the spending on online banner ads, for example, upon which so many of the so-called dotcoms depend.

The links between advertising and the media run deep. Andy Warhol believed that the perfect magazine would consist of nothing but advertisements, making the point that the dependency of publications on advertisements and vice-versa is often uneasy. The newspaper brand must be maintained, but advertisers represent an important source of revenue, and they will advertise more if editorial works in their favour, but then that will tend to erode the brand.

The regulation of advertising is another area of contestation. Many national laws have an impact, in addition to which in most parts of the Western world self-regulatory codes are enforced, in part to stave off periodic demands for tougher legislation. Global media create regulatory problems for advertising on satellite television or the internet. For example, in continental Europe, children are not used as extensively in advertisements as in the UK and US.

The limits of advertising, whether set by taste or code, have been incorporated into the increasingly sophisticated tricks that advertisers play, notably to win so-called below the line advertising. Here the point is to stimulate interest in the advertisement itself, thereby massively increasing its reach. Versace is a leading exponent of this art.

Recently, the advertising industry has been in something of a crisis. The hegemony of advertising agencies has been broken as the industry fragments and as the relationships between advertising specialisms change. The definition of what constitutes advertising is also being stretched, as advertisers exploit new techniques such as the 'infomercial' and product placement to stimulate an increasingly ad-wise public.

See also: **Brand, Consumer, Marketing, Segmentation, Semiotics, Socioeconomics, Subliminal advertising**

Further reading: Brierly, 1995; Cronin, 2000; Fletcher, 1999; Jones, 1998; Wilmshurst and Mackay, 1999

ANTITRUST LAW

The action of a government to sustain lively competition in a marketplace. Also called action against anticompetitive practice.

In America, the first antitrust law, the Sherman Act, was passed in 1890, making it illegal to set up monopolies that reduce competition or build cartels that limit trade. A number of laws have been enacted since, the most important being the Clayton Act and the Federal Trade Commission Act, both of 1914. In Europe, the most significant body of legislation is found in the European Union's 1957 Treaty of Rome, especially Articles 85 and 86. One of the key differences between the US and Europe is that in Europe small- and medium-sized enterprises are allowed to operate as cartels to compete with large firms. This is forbidden in the US.

These laws have also become a powerful tool in combating exclusionary marketing tactics. As long ago as 1912 NCR (National Cash Register) was successfully prosecuted. The most recent and ongoing case concerns the operations of Microsoft. However, antitrust laws are typically of a general nature, or, when covering a large trading area, incorporate the principle of subsidiarity, which means that the enforcement of legislation often proves very difficult.

Legal debate on antitrust focuses on issues such as whether these laws are concerned solely with the operation of markets or whether they aim to stem the eroding effect that large corporations wielding significant economic power might have on the functioning of democracy. The economic theory upon which these laws are based is also questioned, for example, in relating efficiency to organizational size. This confusion in turn gives rise to concern about the effectiveness of recourse to the law when markets are threatened.

See also: **Barrier to market, Competition, Monopoly**

Further reading: Howard, 1983; Kovaleff, 1990

APTITUDE TEST

Aptitude is the ability to learn. Aptitude tests measure that capacity in individuals, often in relation to specific tasks.

Aptitude tests are often used during recruitment or in the management of an individual's career by HR (human resources) departments. Basic tests assess numerical and verbal ability with more sophisticated measures covering elements such as mechanical or administrative capacities. Psychological profiling is also employed by many firms, to assess intelligence or temperament, factors which are not only important in themselves but also in relation to team building.

One example of a test that is generally agreed to deliver good results is the General Aptitude Test Battery (GATB) which the US Employment Service adopted in 1947. It was extensively revised in the 1980s. It consists of a 2½-hour series of tests covering a wide range of aptitudes of use to employees.

See also: **Occupational psychology, Training**

Further reading: Anastasi, 1988; Parkinson, 1999

ARBITRATION

The resolving of disputes by bringing in an independent third party on whose judgement the disputing parties agree to abide.

Arbitration has become one of the most common methods of dispute resolution, since it potentially offers a way to short-circuit lengthy and damaging recourses to law. Many countries have set up publicly acceptable arbitration services. International bodies also exist which are particularly attractive as an alternative to legal systems that favour national interests or local business knowledge. Other advantages of using arbitration include the maintenance of secrecy, the employment of specialist third parties who know the nature of the business concerned, and a certain degree of flexibility it brings in relation to time and place which eases the human sources of conflict in disputes.

Further reading: Elkouri and Elkouri, 1985; Litka, 1991

ARTIFICIAL INTELLIGENCE

The capacity of computers to act like human beings, particularly in relation to logical reasoning.

AI can take many different forms. Improving the way computers interact with humans is one that deploys technology such as 'fuzzy logic' on website search engines. This allows individuals to misspell an entry or use an entry with similar meaning without jeopardizing the result. AI also covers the ability of computers to handle intractable calculations, vital to many forms of forecasting. For example, decision support systems and other analytical tools increasingly use AI to predict likely future scenarios or to identify otherwise hidden patterns in data. Using so-called heuristic knowledge, larger amounts of data from more extensive sources can be incorporated into calculations without rendering them impossibly large to complete. The uses to which this information can be put range from targeting customers in direct marketing campaigns to anticipating computers crashing before they actually do so.

Expert systems are AI applications that capture the knowledge of workers with some expertise and make it available to non-experts in the same or different field.

Neural networking is a related area in which AI is developing fast, the characteristic feature being that it provides the computer with the ability to learn. Neural networks are typically built of many computation units, called nodes, working in parallel, that is simultaneously and independently. An array of these nodes can be 'trained' by adjusting the nodes to alter the way the network responds to various inputs until the correct output results. The system can then be thought of as a tailor-made algorithm with the significant advantage that it can be used to perform calculations very speedily.

See also: **Data, Forecasting, Information and communications technology**

Further reading: Smith, 1998

ASSET

An asset is anything that can be expected to return a financial benefit. It is the opposite of a liability.

The fundamental accounting equation is often said to be the balance between assets and liabilities plus equity used to pay for things owned. A balance sheet places assets on one side and liabilities plus equity on the other so that the accounting records balance. From this, the double entry system follows, since any transaction recorded in the general ledger can be said to have an impact upon assets, called a debit, and liabilities, called a credit. Hence all entries require at least two lines of data.

Many things owned or controlled by a company may count as an asset. Accountants will agree on those that can be measured in monetary terms, bank deposits or property being two obvious examples. However, an established brand or loyal staff, whilst also clearly an asset to a company, are not so easily accounted for. These latter cases can be more readily evaluated in a so-called 'buy and sell' scenario, since then a price is agreed to reflect value. But since they are usually regarded as 'going concerns', when control of the asset is held over time, future benefit may be hard to ascertain and associate with a quantifiable value. The asset may then be regarded as having an intangible benefit. For example, in many high technology companies, an ability to assess the value of R&D spending might be very important when reporting profits. The alternative is simply to publish R&D expenditures and let readers make up their own minds.

Asset quality is a way of assessing the realistic value of an asset which may differ from the reported value on a balance sheet. For example, assets may be segregated according to their risk, with more liquid assets representing less risk. If most of the company's assets are high risk, then the overall value of the company to investors is likely to be reduced.

Asset stripping is buying a company, not with a view to developing its viability, but in order to sell off its assets and pocket the profit. Ethically, this is a questionable activity when it is undertaken with little regard for the needs of customers or employees.

Asset management is aimed at maximizing the way a company exploits its assets. This division of management theory seeks to develop methods by which assets can be effectively allocated. Market forecasting models, for example, assist asset managers in deciding how to invest in various financial instruments to maximize yield over time. Alternatively, decisions will be made over how an organization can best use its buildings or equipment.

See also: **Accounting, Capital, Cash, Labour, Value**

Further reading: Bishop *et al.*, 1999; Chorafas, 2000; Thomas, A., 1999

AUCTION

An auction is a competitive trading environment in which goods of an unspecified price are simultaneously offered to many buyers with the sale being made to the buyer who bids most. It offers an alternative to fixed or negotiated price trading.

Auctions exist in various forms. The so-called English auction is one in which the bidding is transparent. A Dutch auction is one in which the auctioneer begins at a high price that is lowered until a first participant accepts it. First-price sealed auctions consist of bids made in secret with the most attractive bid winning. A variation on this type is the second-price sealed auction, in which the winner under the first-price sealed rules pays the amount bid by the runner-up.

Auctions are used in a variety of situations. The first-price sealed auction is used to secure many public sector contracts. The traditional open-outcry method of selling on financial market trading floors is of the English auction type. However, whilst this practice is tending to die out as stock markets adopt electronic systems that arguably make the market more efficient, the emergence of online marketplaces is seeing a reinvigoration of the form. In business-to-business procurement, these marketplaces are electronic ‘hubs’ that bring together buyers and suppliers into a trading community. The online auction is a variation on this model, designed to facilitate one-off transactions for one-off needs, with the goods going to the highest bidder. Auctions are good for spot sourcing goods. So they are useful if a company has a one-off purchase or when it is buying a new product.

Further reading: Small, 2000

AUDIT

The independent assessment of the current state of the business. This usually includes a process of verification that stated facts are true. Conclusions are presented in the auditor's report.

Traditionally, auditing has applied itself to the domain of finance, but organizations are increasingly finding value from internal audits that monitor other aspects of their activity. Environmental and social audits, for example, have been championed by firms such as Shell in response to the ethical concerns of both shareholders and the public in relation to the company's impact upon the locality. Financial auditing is growing in importance too, partly in response to recent major scandals such as the collapse of the banks BCCI and Barings, and also in order to monitor the increasingly complex demands being made upon accountants.

However, auditing remains something of a mystery to those outside of the profession, and has become more specialized as accounting has become more sophisticated. For example, whilst best practice has evolved certain tools for analytical review or establishing audit trails, an element of subjective judgement remains as auditors decide what evidence to include. Further, rules of thumb can never be ruled out.

Audit risk has developed as an issue too, as the models for reducing the probability of mistakes being made on sampling, for example, become more subtle. In countries such as Canada these have changed dramatically. Here, a Bayesian approach was introduced in 1980.

Auditors recognize the limitations of their science. They are not held responsible for detecting fraud, for example. Auditing provides a degree of assurance, but not insurance, as to the financial position of the firm.

See also: **Environmental audit, Finance, Social audit**

Further reading: Ashton and Ashton, 1994; Bell and Wright, 1995; Lower, 1998; Power, 1997

AUTOMATION

The process of change whereby tasks formerly carried out by humans are carried out by machines. Any definition also requires a conception of degrees of automation because, especially with information technology, functions can said to be increasingly automated as they are carried out by increasingly independent systems.

Whilst automation has been one of the key drivers for businesses since the Industrial Revolution, the term is widely acknowledged as having been coined by D. S. Harder when he was vice president of the Ford Motor Company. This origin in itself says a lot about the philosophy of traditional manufacturing automation and its relationship to mass production. Here it is mechanical devices that carry out specific repeated tasks, either to assist or replace human beings.

The term has broadened out with the advent of computer control, since machines can now be programmed to carry out a far wider range of operations. In goods manufacturing, for example, this has led to increased economies of scale and faster times to market for new products. Indeed, so-called batch production, where different types of products are manufactured in separate lots to meet market demand, is the norm in Western operations.

More recently, automation has extended its reach again. It is now common to talk of office automation, for example, that covers everything from word processing to advanced workflow systems that push and pull electronic documents and information around the organization. Here automation does not so much imply the replacement of human beings as support for, or enhancement of, the tasks they carry out. The most recent phase of office automation is the birth of the intranet, self-help online systems that allow employees to bypass the human intervention that would traditionally have been necessary to complete tasks from filing sick notes to internal procurement.

See also: **Fordism, Technology**

Further reading: Noble, 1984

BALANCED SCORECARD

A management control system for measuring performance that does not rely solely on financial data, developed by R. S. Kaplan and D. P. Norton.

Kaplan and Norton recognized that managers often have a problem assessing staff on factors that, whilst critical to financial returns, are not directly reflected in financial transactions. The four key factors that have a bearing and which are incorporated into the balanced scorecard are: first, the customer perspective or how customers see the company; second, the internal perspective that is the company's own core competencies and excellences; third, the innovation and learning perspective which is the company's capacity to develop and progress in the future; and fourth, the financial perspective or how other stakeholders, notably shareholders, view the company.

Scorecards seek to redress the use of excessive quantities of transactional information for measuring performance that often build up when no alternatives are available. They are also held to be valuable because they enable the company to develop a long-term strategic view of itself: financial information alone tends to lead to reactive responses dictated by the vicissitudes of the markets rather than to proactive planning that focuses on strategy and vision.

The trick is to bring financial and non-financial information together and present it in ways that allow, say, profit figures and customer satisfaction ratings, or product quality and share price fluctuations, to be meaningfully compared. Computers greatly facilitate this capacity, and ERP (enterprise resource planning) applications are proving particularly suited to putting real-time scorecard interfaces on the desktops of managers.

Scorecards are also a useful tool for determining the value of a company since value is increasingly associated with non-financial indicators too.

See also: **Control, Performance, Strategy, Value**

Further reading: Creelman, 1998; Graeser *et al.*, 1998; Kaplan and Norton, 1996

BANKING

In its narrowest sense, banking is the provision of deposit or loan facilities. But the institutions that provide these services, banks, may be engaged in a wide range of associated activities, from receiving, collecting and exchanging to investing, dealing and servicing money – veritable financial department stores.

Banks play major roles in the key functions of any financial system, notably managing resources and risk, dealing with wealth exchange and market incentives, price transparency, and clearing and settlement mechanisms. Commercial banks are often referred to as investment banks in the US and merchant banks elsewhere. Investment banks are different as a result of the contested Glass-Steagall Act of 1932. They provide all the services mentioned above except clearing and settlement.

Banks can also be thought of as providers of liquidity. Businesses fund themselves by borrowing money to invest in the development of their commercial activities that will in due course provide an agreed rate of return to those from whom money has been borrowed. Banks can be involved in this process at a number of levels. At one level they may assist in day-to-day cash flow with overdraft facilities where the cost of borrowing is reflected in the interest rate. However, banks are major investors too, creating profits out of the money deposited with them. They are therefore also important institutions in maintaining macroeconomic stability. Legislation such as Europe's Capital Adequacy Directive is designed to ensure that the risk banks take does not pose a threat to business, in short so that in all reasonable financial scenarios banks will be able to maintain liquidity in markets.

Related to this is the role of central banks. Apart from performing banking functions for commercial banks, central banks hold the national reservoir of reserves and assist governments in running monetary and fiscal policy. Indeed, in relation to the former, Western economies typically allow monetary factors, notably the raising and lowering of interest rates, to be controlled by central banks.

Internationally, the style and principles that underpin banking vary enormously. For example, Islamic banking is currently attracting a lot of attention in the West, with its policy of offering interest-free financing according to Shariah law. Instead, Islamic banks invest directly in the business or become business partners. Islamic banks do well not only in countries dominated by the Islamic system but also in other Arab states and various parts of the Far East.

Japan is home to one of the world's three major financial markets in Tokyo, and the country dominates the list of largest institutions in the world. Although commercial banks now look very similar to Western firms, a mutual principle of *keiretsu* – cross-holdings between banks and businesses – still operates, although it has been severely scrutinized following recent bank failures.

The banking industry in the West is currently in a tremendous state of flux. M&As are common, seeking to exploit recent waves of deregulation, with the general tendency being to create larger institutions and so capitalize on economies of scale and larger markets. So-called new entrants, particularly in the retail banking space, are another source of instability, leveraging brands to offer better customer service. The emergence of online banking is another driver of change, in both the retail and merchant/investment spaces. In worst-case scenarios, online banking threatens to turn banks into mere commodity brokers, as traditional banking services are offered by non-banks or simply taken in-house by businesses.

See also: **Cash, Finance, Liquidity**

Further reading: Munn *et al.*, 1991

BANKRUPTCY

This occurs when a business can no longer service its debts, that is when a negative net worth is registered on a balance sheet, although bankruptcy may be indicated by a number of additional factors including uncontrollable operating losses, insufficient working capital, and an inability to borrow.

Insolvency laws that govern the winding up of a bankrupt company vary from country to country but work, with arguable success, at defending the interests of creditors and minimizing additional costs. In the US, businesses threatened with bankruptcy can file for Chapter 11, also known as being under administration, when debt repayments are delayed. Culturally, being a past bankrupt can carry a major stigma. Although famously, in Silicon Valley, working through one or two failed businesses is regarded as an asset.

Research shows that rates of business failure have increased in recent years, which, apart from macroeconomic factors such as recession, is often blamed on a high debt culture.

Auditors work with various indicators to calculate the likelihood of impending business failure. A good example is E. Altman's Z-Score, which weights a number of financial measures to provide a score that determines the probability. However, it should also be noted that firms can be technically bankrupt according to these indicators but still be regarded as going concerns. Many of the so-called dotcoms, for example, ran simply on their presence in a new industry, although there was a high probability of future failure.

See also: **Exposure, Finance, Risk**

Further reading: Altman, 1993; Davies, 1999

BARRIER TO MARKET

An impediment preventing a company from participating in a market.

Also called barriers to entry, they may take many forms. Natural obstacles include the costs that a firm incurs as a potential entrant or the limitations inherent in a particular market, such as shop space on the high street.

Strategic barriers to market are erected by current market participants to try to protect their interests. They might include the instigation of price wars based upon economies of scale against which small or newer players cannot hope to compete, or the reinforcement of dominant brands.

Artificial barriers to entry can be contrived by current market participants to prevent new entrants. They may be subject to antitrust laws. Artificial barriers also exist because of market regulation that wittingly or not protects cartels and monopolies.

See also: **Antitrust law, Capacity, Competition, Growth, Liberalization, Marketing, Monopoly, Porter's five forces, Protectionism, Saturation**

Further reading: Bain, 1956

BEHAVIOURAL THEORY

Theory derived from observations of the way individuals or groups act.

Behavioural theory has been applied to a wide range of business functions. For example, behavioural decision models seek to describe the influence of an individual or group's character or makeup upon decision making. They contrast with rational models of decision making, that emphasize the way an entity should act, with actual descriptions of how decisions are made.

One result of this different approach is captured in the neologism 'satisficing'. It stems from the observation that individuals often make decisions not on the basis of what optimizes outcomes, as a rational model would suggest, but merely on the basis of what is sufficient or will bring enough satisfaction. The point is that decisions are often made in complex environments in which there are