

100 QUESTIONS

Principles of Management

The economic activity and economic actors

1. The nature of enterprise, aims and social role:

An enterprise is a community of people at the service of the society. It is a private entity but of public interest. It is oriented to satisfy mainly costumers, owners and employees. It also is a centre for developing entrepreneurial, technical, commercial, and organizational skills and an educational centre that promotes: a conception of people and work, virtues such as courage, attentiveness, loyalty, perseverance. The enterprise is oriented to last over time.

2. The role of profit in the enterprise's life:

Profit, in the enterprise's life, has a key role; indeed, it sustains the production, it pays employees' wages, it maintains the company and so forth. In past years economics theories claimed that the unique goal of a firm was that one of maximising profits. But, nowadays, companies aren't just focused in being profitable indeed they also try to achieve social objective such as being eco-friendly or motivating their employees in order to get a better society.

3. The main stakeholders' categories of an enterprise:

The main stakeholders' categories of an enterprise are:

- Employees
- Shareholders
- Government
- Suppliers
- Costumers
- Community

Because they have a direct impact on the company as well as they're directly affected by it.

4. The homo Oeconomicus and Human Being:

For more than 2 centuries, economic sciences have used the model of Homo Oeconomicus to denote the economic essence of human beings. Homo Oeconomicus is a utility maximiser, his sole interest is to maximize his own income and wealth; he possesses a perfect rationality, he is interested only about himself, he is autonomous and opportunistic. Conversely human being is a utility satisfier; he possesses a bounded rationality, he is member of social groups, he is cooperative and trustworthy.

5. The responsibility of management in firms:

Managers in company have several responsibilities that can be divided into two different categories: the first one contains responsibilities based on the economic aspects such as being able to create wealth and, in addition, manage to have an economic sustainability; this means that managers have to find the right balance in order to grant the company to survive, to achieve goals and to be profitable. The second one contains the responsibilities that managers have towards the social and environmental impact that a company may have.

6. Entrepreneurship vs management:

Entrepreneurship is a process which leads an individual or a group to invest personal resources for the creation and management of a new organisation designed to pursue an innovative opportunity. While management is more like a profession that consists of managing a company and checking the operation and production of it. It is mostly about skills.

7. Discuss the pyramid of needs:

At the bottom of the pyramid of needs there is physiological and survival needs that a human being needs in order to stay alive, such needs are: air, food, water (etc.); then there is safety needs that is composed by the things that a human being needs to feel safe, such as: house, insurance, retirement plan (etc.); in the middle of the pyramid we find love and belonging that are the needs which leads a human being to feel loved, such needs are: children, friends, partners; at the second step of the pyramid (starting from the apex) we find the self-esteem needs that complete the human being as a person, such needs are: fame, recognition, reputation, dignity; and at the first step there is self-actualization in which a human being completes his achievement in life.

8. Explain some categorizations of economic goods:

The economic goods are goods and services useful in order to satisfy people's needs. There are different types of economic goods, here are some examples:

- Disposable: set up only for a short amount of time;
- Substitute: that are perceived as similar to other goods;
- Complementary: they complete other goods;
- Public: consume by the society;
- Private: goods that belong to an individual;
- Differentiable: they are unique products (brand makes the difference among one product and another);
- Commodity: they are interchangeable with other goods of the same type.

9. Key features of the four classes of social entities:

The four classes of social entities are: family, firm, state & public administration and non-profit organization.

- **Family:** is the basic social entity in society. Its main purposes are social, ethical and religious; but a family also has some economics goals; the primary economic goal is to fulfil the needs of its members. Family members produce income mainly by external work, but a part can also be produced thanks to shares in listed company, rental properties, bonds. In families we also find activities like paying taxes, buying insurance to cover from risks, incurring debt.
- **Firm:** its primary economic goal is the production of rewards (monetary and non-monetary). The firm's core economic interests are centred on employees and shareholders; they receive rewards produced by the firm in the form of salaries, capital-gains and dividends. The firm's non-core economic interest are centred on suppliers, customers, providers and the State.
- **State and public administrations:** the State is a political, social, legal, and economic system which fosters the pursuit of the common good of the nation. The public administrations' priority is the one of producing public good (especially services). The production of public goods requires financial means; these financial means are collected through taxes, public debt. Its primary economic goals are: satisfy public needs of people that belong to the local community, reward employees. The production of goods it is an end, not a mean.
- **Non-profit organizations:** an organization to be qualified as a non-profit organization needs to be: private and not allowed to distribute net earnings among the people who run the organization. The aim of these organizations centres on social, moral and cultural concerns. The primary economic goal

is never to produce rewards, though a reward for work must be established fairly.

10. The levels of specialization in modern economic activities:

In modern economic activities there are three level of specialization:

- **Specialization by macro-classes of organization:** such as firms, families, non-profit organization, State
- **Specialization within each macro-classes of organization:** especially true for firms because they are highly specialized in the production of specific types of goods
- **Specialization within single organization:** where individuals perform specific tasks

11. The main advantages connected to specialization:

The main advantages of specialization are:

- Higher speed and efficiency
- Less effort
- High quality results

The institutional and governance structure

12. The rights/duties to govern the organization:

The rights you're entitled to when you govern an organization are: to make decisions and to benefit from the residual income.

The duties that you have when you govern an organization are: to assume responsibility and to bear possible negative results.

13. Firm's core stakeholders, expectations and rewards:

- **Employees:** getting a salary, job satisfaction, the chance to grow professionally
- **Suppliers:** they expect on time payment, long-time contract
- **State:** reduce unemployment rate
- **Customers:** they expect quality and fair prices
- **Local community:** respect for the environment, creating job opportunity in the local area
- **Shareholders (risk capital providers):** they expect the company to have success and they want to receive more money than the one they invested
- **Providers of loan capital:** they want to receive the money back plus the interest; they also want the company to be transparent

14. The governance structure of a company: explain the concept and provide the example using the organization you analysed:

Corporate governance is the collection of processes and relations by which corporations are controlled and operated. The corporate governance is a fundamental and key part of an enterprise. It defines who makes decisions within the organization and how. Prima Industrie adopts a traditional governance model, with the appointment of a Board of Directors and a Board of Statutory Auditors by the Shareholders' Meeting. The Board of Directors draws up the Group Strategy. The Board of Statutory Auditors carries out an oversight role. The Chief Executive Officer is tasked with company management.

15. Illustrate the contributions and expectations of the shareholders:

Shareholders (risk capital providers) supply financial means in the form of equity capitals that is subject to the firm's general risk. Risk capital providers have the right to a share in the profits which the firm generates.

Shareholders' expectations are: satisfactory compensation of the capital that they invested in the form of dividends and capital gains (that is the difference between the capital granted and the capital earned when shareholders sell their shares)

16. Illustrate the contributions and expectations of the employees:

Employees provide labour to the firm, it can be qualified according to: time dedicated to the firm, commitment and energy expended during work, skills made available to the firm, results attained. For their work employees expect: regular and deferred wages, consistent with those paid by other firms for similar tasks,

skills and results; agreeable physical and social work conditions; incentives and initiatives that enhance professional skills (for example education and training).

17. The tasks related to corporate governance:

The corporate governance is a fundamental and key part of an enterprise. It defines who makes decisions within the organization and how.

18. The governance bodies of the organization you analysed:

The governance body of Prima Industrie is composed by: a board of directors, **control and risk committee**, board of statutory auditors and by **independent auditors**. Regarding the Board of Directors, sets out provisions regarding the composition, appointment, duration and replacement of the members of the Board of Directors. The company is governed by a Board of Directors, chaired by Gianfranco Carbonato, comprising 10 members (its number is set by the Shareholders' Meeting): 2 directors are executives and 8 non-executives, of which 6 independent.

19. Benefits of corporations:

A corporation is an entity that is legally separated from the shareholders.

Limited Liability: Corporations provide limited liability protection to their owners (shareholders). Typically, the owners are not personally responsible for the debts and liabilities of the business; thus, creditors cannot pursue owners' personal assets, such as a house or car, to pay business debts. Conversely, in a sole proprietorship or general partnership, owners and the business are legally considered the same and personal assets can be used to pay business debts

Ownership transfers: It is not especially difficult for a shareholder to sell shares in a corporation, though this is more difficult when the entity is privately-held.

Unlimited Life: A corporation's life is not dependent upon its owners. A corporation possesses the feature of unlimited life, meaning if an owner dies or wishes to sell his or her interest, the corporation will continue to exist and do business.

The economics activities

20. Define economic activities:

Economic activity is the activity of making, providing, purchasing, or selling goods or services.

21. Describe the difference between functional areas and business areas. Provide an example concerning the organization you analysed:

Business area:

A business area is an organizational unit within accounting that represents a separate area of operations or responsibilities in a business organization. A business area is a product/market area, with its own distinctive features; it differs from other product/market areas in which the same firm operates. For example, if Prima Industrie is having several branches in China & USA then China & USA can be treated as separate business area.

Functional Area:

An organizational unit in accounting that classifies the expenses of an organization by functions; functional areas can be classified as follows:

- Institutional structure design
- Operations
 - Core operations (research and development, purchasing, manufacturing, sales and marketing, logistics)
 - Debt and equity management
 - Management of non-core investments
 - Tax management
 - Insurance management
- Organization
- Information

Classification takes place to meet the needs of cost-of-sales accounting.

22. The five classes of operations:

The five classes of operations are: **core operations** (research and development, purchasing, manufacturing, sales and marketing, logistics), **debt and equity management, management of non-core operations, tax management and insurance management.**

- **Core Operations:** core operations consist of operational processes that identify the technical, economic function of each company. Core operations are divided in:
 - o **R&D:** this centres on activities which establish product features and production methods
 - o **Sales and marketing:** this involve selling the firms' products while optimizing economic profitability
 - o **Logistical processes:** this covers the sets of operations executed in order to transport, store and move raw materials and finished products
 - o **Manufacturing:** this centres on processing and assembling raw materials and parts
 - o **Purchasing:** we can distinguish between 1) buying buildings, machinery, equipment 2) buying raw materials 3) buying various types of private services such as security, cleaning
- **Debt and equity management:** are that set of activities undertaken by the firm in order to cover its financial needs
- **Management of non-core investments:** the aim of this category is to create revenues by investing capital originating from savings
- **Insurance management:** every organization is exposed to some kind of risk which can be covered with insurance policies. The aim of insurance contract is to cover from damages resulting from possible negative events.
- **Tax management:** every organization need to pay various type of taxes for the right to utilize public goods provided by the state. Tax management are activities that involves expenditures and not revenues.

23. Operations, organization and information: clarify the meaning of these three categories of a firm's economic activity:

Operations refer to the extensive set of activities by which the firm actually carries out economic production: raising capital, buying machinery and raw materials,

manufacturing and selling products, paying taxes. Most of firm's employees are involved in operations; indeed, a large portion of the firm's costs and revenues are generated here and consequently, the net income (either it is a profit or a loss).

Two complementary area of activity are required for a firm to have efficient operations: **organization and information**.

Organization can be classified in two groups: organizational design and human resource management.

- Organizational design centres on designing the organizational structure of the firm. The objective in designing organizational structure is to ensure that each employee knows what to do, in which organizational unit he is, who his boss and subordinates are.
- Human resource management consist of recruiting and hiring personnel, and providing orientation.

Information activities are conducted to provide data and information to two groups of users:

- The firm's decision makers who work in various functional areas.
- The firm's stakeholders who need information to decide if and how to establish and grow their relationship with the firm.

The vantage and the resources

24. A classification of competitive advantages:

A competitive advantage is an attribute that allows a company to outperform its competitors.

A competitive advantage must be difficult. If it is easily copied or imitated, it is not considered a competitive advantage.

There are two strategies for establishing a competitive advantage: Cost Leadership, Differentiation.

-Cost Leadership

In a cost leadership strategy, the objective is to become the lowest-cost producer. This is achieved through economies of scale. If a company is able to utilize economies of scale and produce products at a cost lower than competitors, the

company is then able to establish a selling price that is unable to be replicated by companies.

-Differentiation

In a differentiation strategy, a company's products or services are differentiated from that of its competitors. This can be done by delivering high-quality products or services to customers or innovating products or services.

If a company is able to differentiate successfully, the company would be able to set a premium price on its products or services.

Competitive Advantage in the Marketplace

Three great examples include:

1. **McDonald's:** McDonald's main competitive advantage relies on a cost leadership strategy. The company is able to utilize economies of scale and produce products at a low cost and as a result, offer products at a lower selling price than that of its competitors.
2. **Louis Vuitton:** Louis Vuitton's advantage relies on differentiation strategy. The company is able to be a leader in the luxury market and command premium prices through product uniqueness.
3. **Walmart:** Walmart's advantage relies on a cost leadership strategy. Walmart is able to offer 'every day low prices' through economies of scale.

25. Define resources and their role in firms' success:

Firms differ in fundamental ways because each firm possesses a unique bundle of resources. Resources come in many forms, from common factors, to highly differentiated resources (like brand names) that are developed over many years and are difficult to replicate. There are 4 different types of resources: tangible assets, intangible assets, human resources and organizational capabilities.

26. The main tangible and intangible resources in the organization you analysed:

Tangible assets are physical and measurable assets that are used in a company's operations. Assets like property, plant, and equipment, are tangible assets.

Intangible assets are typically non-physical assets used over the long-term. Intangible assets are often intellectual assets, and as a result, it's difficult to assign a value to them because of the uncertainty of the future benefits.

Tangible**Intangible****Human**

8 Plants spread
around the world

Advanced software (NC
Express, Tulus)

E-learning
training to
improve skills
and capabilities

Raw material
such as steel &
alluminium

Research & development costs
(tech center)

«Learn by
doing»
activities,
practical
examples

Laser machines to
cut, weld and
punch metallic
components

6 registred patents in the
machine tool

Electronic office
equipment

Goodwill

Trademark (5 registred)

Production processes

27. Define organizational capabilities and their classification:

Organizational capabilities are not input factors like tangible and intangible assets. They are complex combinations of assets, people, and processes that organizations use to transform inputs into outputs.

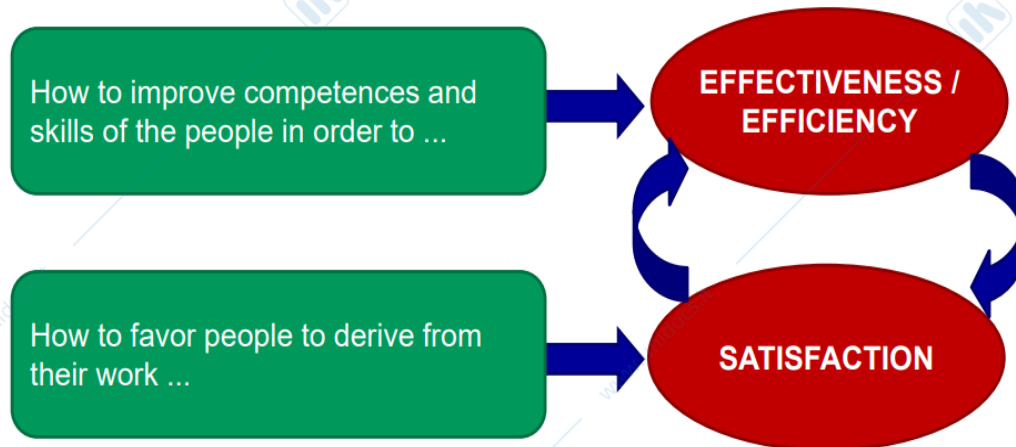
Organizational capabilities can be classified as follow:

- **Organizational capability**: a firm's capacity to undertake a particular activity.
- **Organizational competence**: an internal capability that a company performs better than other internal capabilities.
- **Core competence**: a well-performed internal capability that is central to a company's strategy and profitability.

- **Distinctive competence**: a competitively valuable capability that a company performs better than its rivals.

The Organization

28. The objectives of the organizational design: The objectives of the organization are:



29. Advantages and disadvantages of the multidivisional organizational structure:

The multidivisional organizational structure provides advantages:

Communication between facilities is more effective, problem-solving is manageable and teamwork is encouraged through this structure. A multidivisional organizational structure **promotes motivation** among team members because of the performance/reward connection. It also promotes loyalty among its members.

A multidivisional organizational structure does have some disadvantages. Although **conflict between departments** is common due to competition and differences in values, systems and expectations. This structure also **costs more** to operate.

30. Advantages and disadvantages of the functional organizational structure:

A functional organization is the **most common type** of organizational structure. This is where the organization is divided into smaller groups based on its special functions such as IT, finance, human resources (etc...). The advantages of a functional structure are:

- The team is managed by an experienced person with high ability and skills who can adequately understand and review the entire work.
- The staffers have the chance to get promoted within their functional areas.
- Employees are highly motivated as they see clearly their career path within the functional units.
- Functional specialization can minimize the cost of operation.

The disadvantages of a functional structure are:

- Employees' motivation is greatly affected by lack of innovation.
- Another weakness of functional structure is that there could be a lack of coordination.

31. Advantages and disadvantages of the matrix structure:

The main advantages are:

- Individual is better helped in his job
- Flexible structure
- Faster information flow
- Orientation to innovation

The main disadvantage is:

- Demotivation

32. The management systems for coordination and control:

Management systems provide the mechanisms of communication, decision-making and control that allow an organization to operate and develop. These systems are the primary means through which organizations solve the basic problems of achieving both coordination and cooperation.

33. Role and description of human resource systems:

The central role for human resource management is establishing an incentivesystem that supports the implementation of strategic plans through aligning employee and company goals. The problem of aligning employee goals with those of the firm is a central problem.

34. Describe the role and main characteristics of financial systems:

Financial planning and control system relate to the budgeting activities and to financial targets. Two types of budgets are set: the capital expenditure budget and operating budget. The first one is the money you need in order to make investments. The latter regards the required money in order to run a company.

35. The role of culture in companies:

Culture in companies comprise the belief, values and behavioural norms of the company that influence how employees think and behave. The culture in companies is a difficult phenomenon; they are embedded with national cultures and incorporate elements of social and professional cultures. A key problem is that cultures take a long time to develop and cannot easily be changed.

Industry Structure

36. M. Porter's five-forces model of competition:

The five forces are:

1. Supplier power. An assessment of how easy it is for suppliers to drive up prices. This is driven by the: number of suppliers in the market; uniqueness of their product or service; relative size and strength of the supplier; and cost of switching from one supplier to another.

2. Buyer power. An assessment of how easy it is for buyers to drive prices down. This is driven by the: number of buyers in the market; importance of each individual buyer to the organisation; and cost to the buyer of switching from one supplier to another. If a business has just a few powerful buyers, they are often able to dictate terms.

3. Competitive rivalry. The main driver is the number and capability of competitors in the market. Many competitors, offering undifferentiated products and services, will reduce market attractiveness.

4. Threat of substitution. Where close substitute products exist in a market, it increases the likelihood of customers switching to alternatives in response to price increases. This reduces both the power of suppliers and the attractiveness of the market.

5. Threat of new entry. Profitable markets attract new entrants, which erodes profitability. Unless incumbents have strong and durable barriers to entry, for

example, patents, economies of scale, capital requirements or government policies, then profitability will decline to a competitive rate.

37. M. Porter's five-forces model of competition in the airline industry:

-BARGAINING POWER OF SUPPLIERS:

The power of suppliers in the airline industry is immense because of the fact that the three inputs that airlines have in terms of fuel, aircraft, and labour are all affected by the external environment.

-BARGAINING POWER OF BUYERS

The bargaining power of buyers depends on the fact that they want to reduce flight tickets costs with determined preferences.

-COMPETITIVE RIVALRY

The competition in this sector is very high especially because of the many competitors. The level of low-cost carriers has intensified the competition. Most airlines have reduced prices and upped the level of customer service to remain competitive.

-THREAT OF SUBSTITUTES

The threat of substitutes in this industry is very high, for example a family, for their journey, can decide to travel by car or by bus or by train instead than travelling by the aircraft.

-ENTRY AND EXIT BARRIERS

Entry and exit barriers on the airline industry are both very high. If you want to enter you need an high capital; if you want to exit you need to overstep high barriers.

38. Describe factors which influence the intensity of competition among rival firms:

- Rivalry intensifies as the number of competitors increases and as competitor become more equal in size and capability.
- Rivalry is stronger when the demand of a product is growing slowly.
- Rivalry is stronger when one or more competitors are dissatisfied with their market position losing ground or that are in financial trouble usually react by acquiring smaller rivals, introducing new products, discounting prices.
- Rivalry increases when strong companies coming from the outside of the industry, buy weak firms in the industry.

39. Describe factors which influence the power of suppliers:

The power of the suppliers is low when the good(s) or service(s) they provide is easily available on the open market and is supplied by a lot of suppliers. Suppliers also have a weak bargaining position whenever there are good substitutes for the item they provide. Suppliers also have a weak bargaining position when the company they are supplying is a major customer; in such cases the well-being of the suppliers is strictly linked to the well-being of the company.

Conversely the bargaining power of suppliers is high for example when they provide an item that accounts for a sizable part of the costs of an industry's product.

40. Describe factors which influence the power of buyers:

Generally speaking, buyers can have substantial bargaining power in different situation, such as when large buyers purchase a big percentage of output of the company's output; usually purchasing in large quantities gives buyers enough leverage to obtain some advantages.

Even if buyers don't purchase in large quantities, they still can have some bargaining power:

- If buyers' switching costs to rival companies or to similar products are relatively low: when the products of rival seller are virtually identical, it is easy for buyers to switch from seller to seller and some seller may be willing to do concession in order to keep a client. Buyers have even more power if in this case they are a small group.

- If buyers are well informed about sellers' products, costs and prices. The more information a buyer has and the better bargaining position they are in. The wide number of information on the internet is giving more bargaining power to buyers. It is easy for buyers to use the internet and to find information about prices and features of a specific product.

41. Describe some of the determinants of entry barriers:

A barrier of entry exists whenever it is hard for a newcomer to break into the market or when economic factors put a potential entrant in a situation of disadvantage relative to its competitors. There are different types of entry barriers:

- Economies of scale: this situation force new entrants either to enter on a large scale or to accept a cost disadvantage and to accept lower profitability.
- Cost and resource disadvantages: existing firms may have costs and resources advantages not available to potential entrants. These advantages may be: partnership with the best and cheapest suppliers, possession of patents, better location.

The Strategy

42. The nine components of the business model canvas:

A business model describes the logic of how an organization creates, delivers and captures values. The nine components of the business model canvas are:

1. Value proposition
2. Customer segments
3. Channels
4. Customer relationship
5. Revenue stream
6. Key activities
7. Key resources
8. Key partners
9. Cost structure

43. The meaning and relevance of value proposition:

First of all, the question that the value proposition needs to solve is: "Which customer needs are we satisfying?" The Business Model Canvas' value proposition provides a unique combination of products and services which provide value to the customer by resulting in the solution of a problem that the customer is facing.

Just to make an example, the value proposition of a company that sells wheelchairs is making sure that people with legs' problems can go out without being forced to stay in the bed.

44. The customer segment: description and application

First of all, the question that the customer segment has to solve is: "Who are our buyers?" The Customer Segments defines the groups of people or organizations a company aims to reach or serve. Customers can be segmented into distinct groups based on needs, behaviours and other traits that they share. A customer segment may also be defined through demographics such as age, ethnicity, profession, gender, etc or on their psychographic factors such as spending behaviour, interests, and motivations. An organization can choose to target a single group or multiple groups through its products and services.

There are different types of market segments:

Mass market: Products and services which target the Mass Market segment are appealing or fulfil the needs of a wide cross section of the population

Niche market: refers to a customer segment with extremely defined characteristics and very particular needs. This segment requires, or rather expects, a highly tailored product, custom made to suit their needs.

Segmented: Some businesses choose to provide products and services to customer segments which may have very little variations in their needs and requirements.

Diversified segments: An organization which opts to serve diversified customer segments is basically picking customer segments with very different needs and wants. The customer profiles have few overlaps but due to varying reasons, the organization sees value in investing in appealing to both these diverse segments.

Multi-sided markets: When customer segments are related through dependency, it makes business sense to serve both ends of the equation. Hence, for a credit card company, it is not just imperative that customers opt to use their credit cards but equally important for stores to accept their credit card. If either segment fails, the other will automatically follow suit.

45. Explain four possible revenue models.

There are many different types of revenue models; one of the most known is surely the **Freemium**; in the freemium revenue model a product or service is provided for free, but a price is charged for additional features or services. This revenue model is used by a lot of company, such as: Spotify, LinkedIn, Dropbox and so on. Spotify

provides the most famous app to listen to the music for free, but, if you want, you can upgrade the app with better features by paying a monthly fee.

Another revenue model is **Advertising**: an advertising revenue model is usually adopted by media houses and information providers which usually earn money by including advertisements in the content provided. This revenue model is widespread in both offline and online businesses and the company makes money by charging the advertiser: per size of the space offered, thousand impressions or per click on the advertisement.

The **subscription** revenue model entails offering your customers a product or service that customers can pay for over a longer period, usually month to month, or even year to year. This revenue model is adopted also by online media services providers, such as Netflix.

The **renting** revenue model is created by temporarily granting someone the exclusive right to use a particular asset for a fixed period in return for a fee. For the lender this provides the advantage of recurring revenues. Renters, on the other hand, enjoy the benefits of incurring expenses for only a limited time rather than bearing the full costs of ownership. One of the most known examples are the car renting companies that allow you to use a car (for example, during the time of your holiday) in exchange for a fee.

46. Explain four possible pricing models.

The **“Razor/Razor blades model”**: this model involves a reusable part (for example the coffee machine) that is sold in a cheap way and a part that must be replaced every time that you use it (coffee pods) in which the price is charged

The **competitive model**: In heavily competitive environments, the price has to be competitive, no matter what the cost or volume.

Volume pricing: A pricing strategy that allows discounts for bulk purchases. Typically, the greater the number of units purchased, the greater the discount allowed.

The **value pricing**: If you can make a clear case for the value your product offers to the customer, then you can price in proportion to the value. It does work for new drugs that solve critical health problems.

47. The business model of McDonald's

The Business Model Canvas of McDonald's can be described as follows:

- McDonald's is famous for its **value proposition**: food of a constant quality that is served quickly and consistently across the globe.

- The main **customer segments** are families, youngsters, the elderly and business people.
- McDonald's main **strategic partners** are its franchise holders. At year end 2013, more than 80% of McDonald's restaurants were franchised. Together with its suppliers the company's model is based on a three-legged stool: suppliers, franchisees and McDonald's. Each leg must thrive for the business to be profitable.
- The **key activities** McDonald's engages in is the marketing and selling food and beverages.
- **Key resources** are the company's employees and its restaurants on a-locations.
- The **customer relationship** takes place online on the device preferred by the customer.
- McDonald's **distributes** its products through the restaurants.
- The **cost structure** consists of employee salaries, facility construction costs, raw materials procurement and marketing costs.
- McDonald's **revenues** are generated at the restaurants owned by the company itself and those owned by its franchise holders.

The production capacity and economies

48. Explain the importance of standardization:

Standardization allows the company to take advantage by reducing cost thanks to the standard processes and mass production.

49. The concept of economies:

An economy encompasses all activities related to production, consumption, and trade of goods and services in an area. An economy can be applied to everyone from individuals to entities such as corporations and governments.

50. Production capacity: concept and examples from companies operating in different industries.

The production capacity is the maximum amount of output which can be produced in a certain unit of time.

The production capacity of firms operating in the hotelier business is measured on the number of guests that can be hosted in a certain amount of time

The production capacity of firms that operate in the consultancy firms is the number of consultancy hours effectively done in a certain unit of time.

The production capacity of firms operating in the car business is measured on the number of car produced in a certain amount of time.

51. Economies of fixed-cost absorption: definition and sources, providing appropriate examples.

Conversely to the variable costs, fixed costs are that costs that do not vary in proportion to production volumes. The fixed-cost absorption gives rise to lower cost per unit when the level of utilization of a certain product rises. For firms which have higher fixed-costs, the potential to exploit fixed-costs absorption economies are greater than for firms with greater variable-costs; for firms that present higher variable costs their costs increase in direct proportion to the increase in production volumes.

The extent to which a company can go into scale-economies is limited by factors:

- **Market-related considerations:** consumers are not necessarily willing to buy all the items a firm produces; there is a limit to their capacity and willingness for absorption. Therefore, it makes no sense to install huge capacity if the market cannot absorb it; the firm would run into diseconomies that is linked to the non-absorption of production capacity.
- **Differentiation:** in many sectors customers want highly differentiated products; differentiated in the fact that they cannot be manufacture in the same production structures. This deters producers from installing large capacities.

An example can be seen in 2 pizzerias with the same production capacity and fixed costs; the first pizzeria on an evening fails to satisfy the maximum production capacity while the second one succeeds in satisfying the maximum production capacity. The fixed costs absorption are spread better in the second pizzeria because it can spread the fixed costs (that are the same also for the first pizzeria) on a greater number of customers.

52. Economies of scale: definition and sources, providing appropriate examples.

Economies of scale are the reduction in "Cost per unit" which results from installing greater production capacity. **Higher production capacity leads to lower cost per unit.**

There are different conditions to enable a firm to achieve the economies of scale advantage:

- **The indivisibility of certain inputs:** certain production factors cannot be broken down in size or in cost below a certain threshold. These factors have

the same costs and size also with a wider interval of production capacity. For example, in a restaurant the cost of a fully equipped kitchen.

- **Enhanced input productivity due to the effect of specialization:** as production capacity grows in size, both human and technical resource can become more and more specialized. More highly specialized resources are capable of creating an economic advantage because they perform their task very efficiently and at high levels of quality. An example can be found in the R&D department of a firm, where researcher may specialize in a specific object of study. This will facilitate speed and efficiency in results.
- **Geometric properties of containers:** for production conditions involving containers, economies linked to geometric properties are generated which are well-known to engineers. In any production process there are container: buildings, stadiums, warehouses and so on. In every activity that uses containers, the production capacity is linked to container size. Cost savings can be attained thanks to economies of scale
- **Greater efficiency of larger engines and plants:** the larger the production facility and the more efficient the operations are, where size refers to the power of the plant. If we consider engines, doubling the power doesn't mean doubling energy or fuel consumption.
- **Lower per unit purchasing costs:** as production capacity increases, the firm buys more input and, usually, gets a better sale price. The cost savings can be attributed to the fact that the firm acquires more bargaining power when it becomes a key customer by buying in substantial volumes. And in part can be attributed to the fact the suppliers prefer to sell larger quantities to a single buyer because of every transaction entails a series of indivisible costs

53. Economies of learning: concept, sources, examples.

The phenomenon of economies of learning has been documented for the first time in 1925 in an air force base in the US; the base commander noticed that the number of hours of labour needed to assemble one aircraft gradually decreased as the number of aircraft produced progressively increased. The economies of learning consist on the progressive decreasing of the costs per unit produced due to the accumulation of experience.

There are different sources for the economies of learning:

- Enhanced skills in carrying out activities: the most common source of experience is the ability of people to learn how to improve their work habits and how to perform job in a more quickly way.
- More accurate selection of production resources: experience helps us to understand which production resources are most appropriate for carrying out a given activity. Experience involves selecting the best raw material in order to obtain a higher quality product. For example, learning enables

bakers to choose the best ingredients, mix them together in optimum quantities and improve product quality for example, in the baking time.

- More efficient coordination among people and departments: with experience, workers, get to know one another and learn to work as a team, to work with other teams (other production departments), to coordinate different plants processes. These learning processes are complex to reach and time-consuming, but they are the real basis for efficiency.
- Higher programmability of processes: experience means that events are more predictable, and response time to non-standard circumstances is faster. This makes it possible to plan processes more effectively by accurately timing each operation, optimizing the mix of different production capacity and so on. For example, we can consider the situation when a new product is launched: for the first weeks imbalance is inevitable (for example oversized or undersized purchasing and production with respect to sales, delivery delays...); then, gradually, the firm starts to understand consumers preferences, the response time of supplier and so on. When this happens all the activity can be programmed
- Simplified products and processes: when people gain experience regarding a certain product or production process, they can also take different pathways to simplification, leading to more efficiency at lower costs.

The cost structures

54. The distinction between fixed costs and variable costs: concepts and examples:

The Variable costs are strictly related with production and sales volumes. Variable costs include: raw materials, packaging, sales commissions.

Fixed costs aren't related to production and sales volumes. Examples of fixed costs are: labour, rent, insurance and so on.

55. Fixed costs and variable costs: concepts and some examples from the company you analysed.

The main fixed costs that Prima Industrie have to bear are: services and rent, amortization and depreciation.

Instead the main variable costs that they have to bear are: raw materials, consumables, goods and so on.

56. The formula illustrating the break-even point in term of volume and provide an example.

It is the point at which total cost and total revenue are equal.

The formula that describes the break-even point in term of volume is:

$$V = (FC)/(SPu) - (VCu)$$

Legenda:

V: volume

FC: fixed costs

SPu: selling price per unit

VCu: variable costs per unit

An example:

For a T-shirt firm the data needed to calculate the BEP are:

- | | |
|-----------------------------------|----------------|
| • Average price per T-Shirt: 25€ | Revenues |
| • Variable costs per T-Shirt: 10€ | Variable Costs |
| • Total fixed costs: 300,000€ | Fixed Costs |

$$V = 300,000 / (25 - 10) = 20,000$$

This means that this T-Shirt firm has to sold at least 20,000 T-Shirts to reach the break-even point; in other words, they have to reach this threshold to cover all the costs of core operations and start earning

57. Contribution margin: definition and method for calculation.

The contribution margin per unit (CMu) is the computation of the difference between selling price per unit (SPu) and the variable costs per unit (VCu). The total margin contribution is the difference between revenue and total variable costs

$$CM = R - VC$$

The unit contribution margin can be defined as the contribution that the production and sale of each unit of output provides in covering the fixed costs of core operations and realizing operating income. In the t-shirt example the firm gains 25€ for each t-shirt sold and lose 10€ (in costs for materials, maintenance and so on) leaving a margin of 15€ to cover fixed costs and generate operating income. This income will be needed to cover financial charges and fiscal expenses. Any leftover counts as net profit.

58. The degree of operating risk within a company.

Operating risk is the varying degree of probability that a firm will face particularly negative or positive net income, in relation to the fluctuation in production and sales volumes.

The firms that have higher operating risk are the one that present a lot of fixed costs and few variables costs, but a higher risk also means higher profitability; while the firms that have a lower operating risk present a great number of variables costs and a low number of fixed costs, and, therefore, a lower profitability.

The scope of the firm

59. Sources of transaction costs

A transaction occurs when a good or service is transferred by means of an interface which is technologically separable: one activity ends, and another begins. Transaction are divided into two groups: internal and external transactions; transactions costs take place in external transactions. Transaction costs are divided into explicit and implicit: Explicit costs are easier to estimate, they are usually related with selecting and monitoring the counterpart; implicit costs instead are harder to estimate, and they usually emerge ex post (after the transaction has taken place). The sources of transactions are mainly three:

- **Informational complexity:** As information becomes more complex the market become less transparent. For example, if I outsource the cleaning services I can easily find out if they're doing a good job. But if I outsource something more complex I can't control right away whether they're doing a good job or not, I need to wait a certain amount of time.
- **Resource specificity:** suppliers that provide a unique item; they can set a monopolistic policy.
- **Possibility of opportunistic behaviour:** cost that may come with an inadequate behaviour. I have to hire someone to check if someone is acting improperly.

60. Advantages and disadvantages of internalization

Internalization consists of managing certain processes inside of the company instead of heading outside to hire someone or make any partnership with other companies. Of course, internalization has its advantages and disadvantages. The main advantages are: the company would be able to reduce transaction costs because they don't have to externalize anything and so they don't have to pay third parties; reducing competitors access to strategic resources and interiorize strategic skills. The main disadvantages are: the investments that the process of internalization has to bear to take on new economic activities; the dis-economies of scale; strategic inflexibility and concentration of risk.

61. The three dimensions of economic activities extension

- Inter-functional extension
- Vertical extension
- Horizontal extension

62. Inter-functional extension: what is it and criteria for the decision

All the economic activities of a firm can be broken down into functional areas, such as: Marketing and sales, research and development, logistics, production, human resource management, purchasing and so on. At this point every firm needs to make decisions on two levels:

1. How many resources should be invested in each function? How much R&D should be done? (and so on for the other functions)
2. Which functions should be carried out inside the organization (internalization) and which functions should be outsourced (externalization)?

The choices regarding inter-functional extension follow these criteria:

- Efficiency and cost
- Transaction costs
- Strategic criticality

63. Horizontal extension: what is it and criteria for the decision

Every firm has to constantly contemplate the number and diversity of business areas in which it operates and come to decision on its level of diversification. There are firms that run mono-business and others that run dozens of business and of course other firms that are between these two extremes. In the language of modern business, diversification strategies are also called "portfolio strategies". To more

fully understand what causes the success or failure of a portfolio strategy there are some criteria:

- The capacity to generate or absorb financial resources;
- The phase in the life cycle of the product;
- The attractiveness of the market;
- The competitive positioning;
- The non-financial synergies;
- The capacity to generate strategic know-how.

64. Vertical extension: define the notion and describe the main criteria for decision of make or buy

Vertical extension (or vertical integration) of economic activities refers to the number of phases in the production chain which are carried out by the firm itself. If only one specific activity is undertaken by the firm, it has low degree of vertical integration. Conversely, if a firm carries out all the production phases, from extracting raw materials to selling to end consumers, it has high vertical integration.

Firms tend to integrate upstream and downstream for the following reasons:

- To economize in terms of transaction costs;
- To interiorize strategic skills or resources;
- To minimize competitors' access to strategic resources.

65. Economies of scope: sources and advantages.

Economies of scope arise when the production of 2 or more goods simultaneously generates economic advantages that do not occur when these goods are produced independently; in fact, the same resources are utilized to create, design and sold 2 or more goods.

The sources of the economies of scope are:

- Sharing material elements of the production structure: raw materials, plants and equipment
- Sharing material elements of the sales structure: distribution channels and networks
- Sharing intangible resources (that are the result of previous investments): image, know-how, managerial resources, technologies.