BUSINESS SCHOOL IN A BOX

LEADERSHIP
FINANCE
ACCOUNTING
STRATEGY
MARKETING
ECONOMICS
VALUES

Peter Zale

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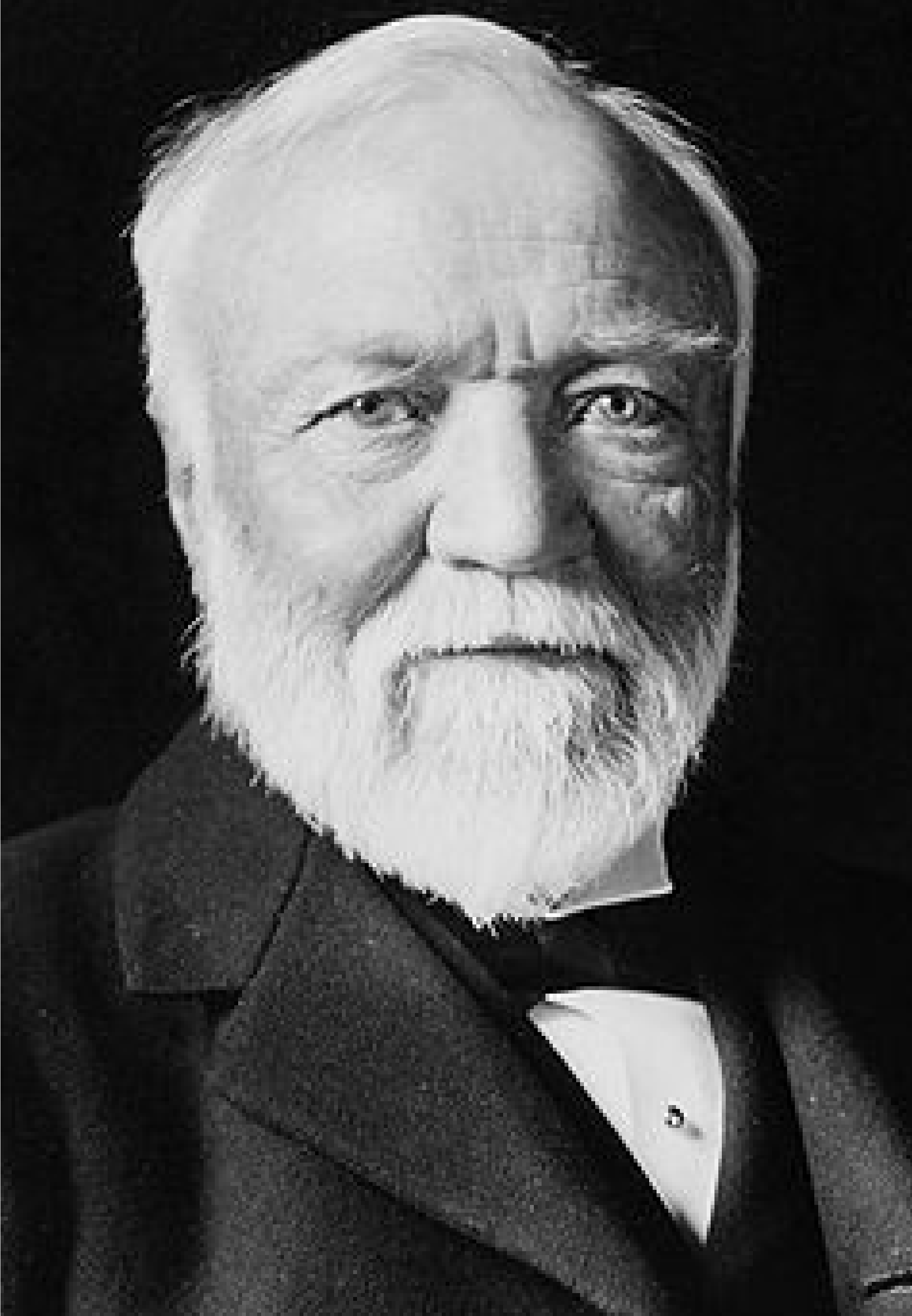
"Do not look for approval except for the consciousness of doing your best."

Andrew Carnegie



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"Before everything else, getting ready is the secret of success."

Henry Ford

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INTRODUCTION

INTRODUCTION

Business School in a Box is an attempt to rewrite, or perhaps initially write the rules of business education for young people. I believe business can be introduced to high school students through essential concepts and philosophies. I believe we can give students the impetus to consider business as a career or apply its lessons to their lives in other positive ways. I believe, at core, business education is about learning a method of thinking. In this study, that method will be applied to seven topics: leadership, finance, accounting, strategy, marketing, economics, and, finally, though hardly least importantly, ethics and human values. It is important though to remember that understanding how to think like a business person means more than learning all the elements necessary to make an enterprise or organization work profitably. It means training your mind and emotions in such a way as to make you an effective and compassionate actor in the world.

One very important thing about business is that it is inseparable from daily life. In the real world compassion can exist behind actions that are harsh. To be a compassionate actor in the world, one must sometimes balance reality and humanity and make decisions that respect both. Make no mistake, while you may never have to fire someone, you will be making similarly tough decisions all your life.

We will try to help you understand what kind of leader you might be. You will learn something of how you learn and what you may want to learn more of as you move forward in your education. Each of us has the potential to be a leader. After all, we lead ourselves every day.

The second section of this study will be about finance. Everyone knows basically what finance is. It's how you pay for things. But the ins and outs of

the financial world can be quite mysterious. Finance is as much about history, geography and culture as anything else. Also, to understand finance is to have a great deal of power in business. Put simply, finance encompasses everything a business is and does. On a formal level, a business exists to make money and everything in it can be liquidated into money. Finance is how a business makes itself move and grow. It is the heart that pumps life into it.

In the finance section we will talk about a particularly interesting concept: of value. When it comes to finance, the term "value" is very changeable. Depending on where you are in the world and what day, year or even hour it is, the value of an asset (something you own, whether a product or service or even currency) can be quite different. Smart financing is about knowing at what point and time what you own can be sold for the most money and what you want to own can be obtained for the least. It's a 3-dimensional balancing act of time and space made increasingly faster and more challenging as the world grows smaller and communication becomes a 24-7 affair.

The next area to be studied will be the old stand-by: accounting. What is accounting? Just that: accounting. It's a taking stock of something that's done by a firm usually four times a year to show the world what's really going on within it. Because accounting uses financial numbers to measure things, it intends to skirt hype and be honest. Some of the largest and most important companies in the world are accountants: Deloitte, Ernst & Young, KPMG and PriceWaterHouseCoopers. These are all very powerful firms that use their accounting skills to tell investors whether other companies are telling the truth. This process is called auditing. People trust what accountants say because accountants have no stake in the companies they audit and so no reason to lie about them.

As you may know, several accounting firms got into trouble a while back because they began offering consulting services to the businesses they audited; that is, they offered advice to the businesses on how they could be more successful, what things they might invest in, etc. The problem with that was these accounting firms compromised their integrity tying their interests to those of the company. It would be like paying a teacher to give you advice on how to get a better grade. The teacher would have an incentive to give you an A even if you didn't deserve it.

The fourth subject of the course is strategy. Business strategy can be quite elegant. Companies like Walmart and Southwest Airlines are very successful and everybody's heard of them, but not everybody knows the strategies underlying their success. You may know that Southwest keeps a lot of flights in the air and they're usually pretty full. But that's not why they're successful. They're successful because they defined being an airline in a different way than anyone else. They looked at the essence of what an airline was and reworked it to fit a need they saw in the world. Some people call this thinking outside the box. Some people call it just thinking.

The ancient Greek philosopher Aristotle would understand things by breaking them down to their essences. He would take a concept like art or nature and break it down to its reasonable component parts, what it is and what it does. In business, it's often very instructive to look at what something does in its most essential form. For instance, an airline transports people from one place to another. So break that down. Ask yourself why are these people traveling? What other types of travel could they do instead of flying? Why are they flying and not driving? If I was able to price my flights closer to what it would cost to drive or take a bus or train, would I get a lot of business? If you were Southwest,

you would and you, in fact, did because that was Southwest's strategy: to offer people a choice to fly fairly short distances for a price similar to the cost of driving, but obviously a lot faster. Southwest wasn't concerned with flying people to Europe or even Canada. They wanted to take people from Austin, TX to Galveston, TX. Walmart, too, had a smart and simple plan, as did Microsoft, Cisco, Johnson & Johnson, and many others. All these companies did a few basic things to be successful and then didn't deviate from that path very much. That's a key to successful strategy: It is something that is simple, repeatable and (and this one is really important) measurable—because you have to have a way to tell quickly if you're following your procedures every day.

Part five of our class, marketing, is a part of strategy. Marketing is how you present yourself to the world. For example, Walmart markets itself as the low cost leader and wraps that message in an image of very basic American values, thus making the point that it is the store for everyone. So what is their chief strength as a competitive business? Price. How they keep their prices low is their special ability, what we call in business a "core competency". But the fact that they can do it means that this is what they're going to shout to the world about, and because they sell what everyone needs, they're going to try to appeal to the greatest number of people possible, hence the all American image they put forth.

You've probably seen those ads with the Southwest workers saying good-bye to the luggage they love so much. I like those ads because they're pure Southwest. They say on the one hand Southwest is cheaper than the other airlines since they don't charge for bags; on the other hand, the ads also say that Southwest offers far less hassle and is a lot friendlier than other airlines. All of which is true and part of its business strategy. Southwest's marketing approach is to simplify and make more casual the whole flying process. It's just them getting you where you

want to go cheaply and on time, and maybe having a little fun while doing it. Their strategy underpins that.

More verbiage is written about marketing than almost any other aspect of business. And why not? Marketing itself is a bunch of messages. And since marketing is such an inexact thing, it invites all sorts of opinions and ideas. Marketing also connects to other equally inexact sciences, like psychology and sociology, as it strives to understand why people think and act as they do in order to sell them products and services. Another reason why marketing gets so much attention is it is something we all understand on a personal level. After all, we all market ourselves to the world everyday. We are always trying to cast an image about ourselves to bring about a certain reaction and make things better for ourselves.

Part six, economics, is in some senses the other side of marketing. Like marketing, economics is concerned with predicting and shaping human behavior. But where marketing uses psychology and sociology, the economist will use statistics and probabilities. And in either case, they're pretty much inexact sciences.

The Federal Reserve is filled with economists who make decisions based on our country's behavior. They decide how much money will be let into the banking system, i.e., into our country's economy, at any given time. They do this depending on what they think the country needs, whether it is to keep inflation low or support the creation of new jobs. In either case they are using data and mathematics to enact a very human agenda.

Economics does say some important things about value as well. There's an old axiom in economics about the "Tragedy of the Commons". It states that

something owned by everyone will be taken care of, i.e., valued by no one. The implication being that the only way to value something is to value it selfishly. No wonder economics has been called "the dismal science". Value, to many economists, is seen simply as activity without any real sense of it being good or bad in any kind of moral or ethical sense. To many economists, the morality of something is how much economic activity it generates. So does that mean if more people liked to commit murder, economists might think it a good thing? Probably not, but the point is they're kind of a detached group of folks.

As we talk about our seventh section of the course, values and ethics, we will find yet another meaning for value, one that we are more used to. Human value in business refers to the quality of the people you hire, the quality of your treatment of them and the quality of your company as a result. The point of valuing your employees and treating them well is that motivated and happy employees will do the best work. If people feel respected, fulfilled, well paid and comfortable, their natural abilities will come more to the fore.

Human values are also about what your company stands for. Most companies have what are known as strategic principles. These are a set of guidelines or values meant to help employees make decisions. Sometimes workers get involved in situations where they must decide between two or twenty options and they can't go to a boss or someone else to help them. What do they do? They use strategic principles. For example, at Federal Express, the strategic principle was to always tend to the new idea or technology. So, if you had a choice, you might be able to make it by looking at it in terms of that principle. If you had to choose between two different software packages to purchase, you'd choose the newest one as opposed to the cheapest one.

INTRODUCTION

As we study business, we'll find it's a subject both familiar and unfamiliar. I remember when I first learned about hedging and futures, which will be talked of in the finance section, I was surprised at how simple the concepts really were. Much of business seems mysterious until it's explained. What questions do you have? Here are some just to get started

- Why do stocks go up and down?
- What are commodities and why are they in a market?
- As an investor, why would I care who the next CEO of Pepsi-Cola is?
- What is an annual report and how do I interpret what it says? Doesn't every company say the same things about itself?
- What makes one company better than another?
- Why should I ever work in business? What's in it for me?
- What's in it for me even learning about business?

Indeed, what is? That's what you have to decide. And what's in it for you is what's in it for the world, because ultimately business is about you, the decisions you make, the things you want and the things you want to give. If you want to give anything to or get anything from the world, it's very likely you're going to do it through some form of business. That's what business is: the process of how we do, give to, and get from one another.

So, let's get started.

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LEADERSHIP

The irony of great leadership is that it may well not be something you would want anyone you care for to aspire to. The truth is being a great leader is not only very difficult and time consuming; it also can eclipse your identity. Think of Gandhi or Lincoln, Elizabeth I or Martin Luther King. Amazing, legendary people, all of them, but how hard was it to live with them? How cut off would you feel from them if you did live with them or even knew them?

The greatest leaders are men and women who stand apart from their fellows not because they are great leaders, but because standing apart is what they do naturally. They have a foot outside of the world most of us live in. They have set themselves on a quest to serve an idea or ideal, whether England or justice or The Union. The fact that they become leaders is simply a happy accident for the rest of us, or perhaps inevitable given who and what these men and women are.

Though we don't have occasion to think of this much, this same aspect of leadership applies to leaders of companies. Leaders of great companies have generally been people who rose from the ranks, people from unassuming backgrounds who found themselves in positions of power; not so much because they craved it, but because they so closely held the organization's goals to themselves and as defining themselves, they became the inevitable choice to lead it. The suppressed their own egos and supplanted them with the identities of their companies.

The greatest leaders tend to be very self-deprecating individuals who live very modestly and don't see what they do as anything more than following what is the right thing to do. They are highly spiritual beings who answer to something that others mostly cannot or do not care to share in. The Greek playwright

Sophocles posed that all people have three masters: God, society and family. The greatest leaders take the relationship with God (however you characterize it—you could say an idea or ideal) as far more important than the other two.

The greatest leaders manage to do one thing no other leader, despite how talented they are, can do. They have their success follow after them once they've gone. Look at the greatest example of this not happening: Alexander The Great. Great leader? Not so much. His kingdom barely survived his death. In fact, in literature the term "Alexandrian" denotes a vapid and dry idea, referring to the failure and cultural emptiness of Alexander's empire. Alexander was too much the egocentric individual—really too much like the rest of us—to put the entity he served above himself, hence it is no surprise it couldn't survive him. It's soul was him.

Compare Alexander to Darwin E. Smith. Who? Indeed. Darwin E. Smith was an unassuming Indiana farm boy who led the turnaround of the company Kimberly-Clark from obscurity to being one of the top paper products companies in the world. Yet when The Wall Street Journal tried to write a piece on him, he could hardly give them anything at all to write about. He just stared back at the reporter and said his managing style was "eccentric". He had no answers, advice or philosophy to share because his only real method was to be the company he ran. Case in point: He lost a finger as a young man and showed up for work the next day. Two months after he became CEO of Kimberly-Clark, he was diagnosed with cancer and given less than a year to live. He calmly told the board of directors he had no intention of dying and subsequently served 20 more years. This guy was connected to something. The strength of his leadership has been proven by Kimberly-Clark's great success after his departure.

The first thing great leaders need is an eye for reality, all of reality, from the

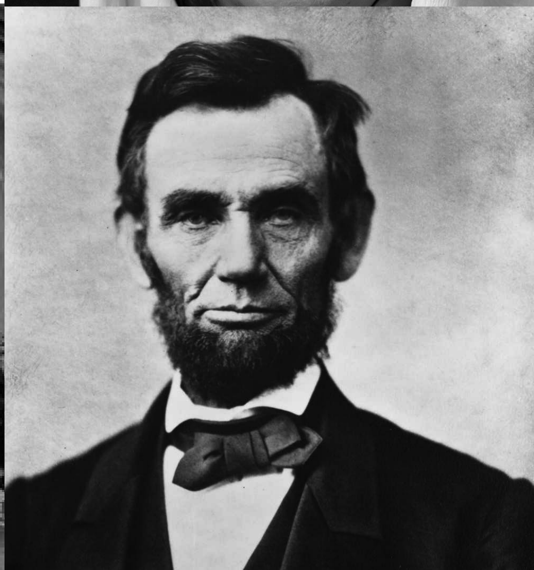
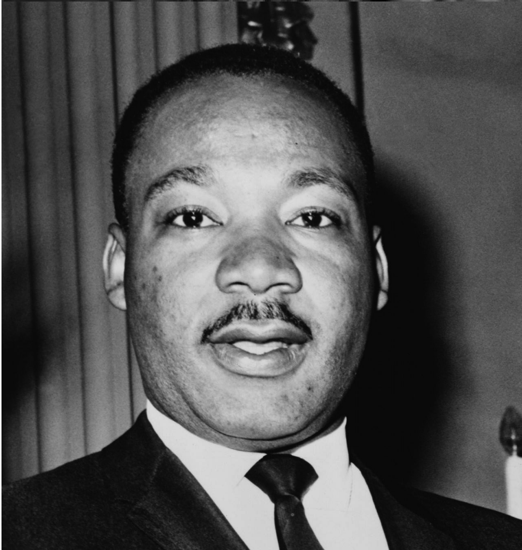
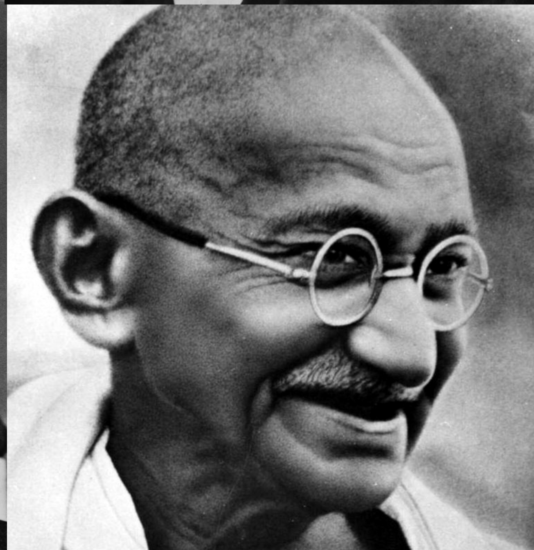
good to the bad to the indifferent. Don't suppose John Adams, Thomas Jefferson and Ben Franklin didn't know only one-third of the country wanted to break from England. They did. Yet they deeply felt that what they were doing was right because they so deeply held the idea of America. They had that spiritual component in great supply; the connection to the ideal.

Now when Darwin Smith took over Kimberly-Clark, he had a problem. Not the problem of Adams and Jefferson, but a big problem nonetheless. His company's core business of selling a certain type of coated paper could never be more than a mediocre success. They'd survive. Life would go on. But what good would that do to support the mission of the company to grow? There was no way for the company to truly fulfill its mission, i.e., its ideal.

However in consumer paper products (diapers, paper towels, bathroom tissue, etc.) there was a chance for great growth and success. There was also a chance for great failure as there were very tough competitors in this sector. So, following the example of Cortez, who burned his boats so his men would either succeed or die, Smith cast his lot with the faith that Kimberly-Clark had the ability to thrive in this new sector and sold off its old business and invested entirely into the new one.

They succeeded. Kimberly-Clark rose to the top of its market. In 20 years they were beating their competition including the giant Procter & Gamble. Darwin Smith's is a success story for the ages but one few people will ever know about. There are others like him, other men and women who have run companies and made them great, and watched them stay great after they left. They define the greatest leadership.

The "Immortal" Darwin Smith.

Honestly, we should think twice before we commit ourselves to being leaders of any sort. We have to be sure we want or are capable of giving up that much of ourselves to an idea, to something greater than us. Perhaps we are and maybe we will. Or perhaps we'll be leaders in a smaller sense. But we better know what it takes to be really good and to give those we lead what they need. We ought to know that great leadership is about a commitment that dwarfs most if not all the other things we do.

Certainly we're all leaders of at least one person, right? So how do we go about leading or managing the person that is us? Well, there are several ways, but before we start to figure those out, we need to understand just who we are and how we think. Now assessing that can be a long drawn out affair, taking years of psychotherapy and self-reflection. Or it can also take as long as it takes to answer some questions about yourself in a psychological self-assessment. Remember, this is business we're talking about. It's better to try to find effective answers as quickly as you can rather than drag the process out over many years. And these assessments are pretty good at what they do, so if you don't have time to do the long work, it might be a good idea to try this.

Understanding your learning style is helpful way to start since it gives you some clues as to how you can best do what you need to do through life, i.e., learn. For example, do you process information better when you listen to it as opposed to when you read it? If this were true then perhaps it would be smarter to listen to audio books than it would be to read them. Perhaps you learn best through experience. Perhaps you like systems thinking more than emotional thinking (assuming someone tells you what these are). All of these questions

Indra Nooyi, Benazir Bhutto, Elizabeth I (portrayed by Cate Blanchett),.
Abraham Lincoln, Martin Luther King, Gandhi

help determine what will be the best way to lead yourself through the situations you'll encounter.

So what are ways to learn?

Experiencing

Learning through experiencing means going out and being with people and being sensitive to them and their feelings. It means listening to a teacher not just for the words the teacher says but for how he or she says them. It means thinking about that and drawing conclusions.

Observing

Observing means looking at how things work and then making judgments about them. It means looking at things from different perspectives and looking for the meaning of different things.

Thinking

Thinking here means logically analyzing ideas. It also means planning systematically and acting on the intellectual understanding of a situation.

Experimenting

Experimenting means learning by doing. it means going out and doing things and seeing what results from that. It means taking risks and influencing people and events through action.

Between these are other aspects of how you learn. For example, if you feel your learning style is somewhere between **Experiencing** and **Observing**, then it may well be your style is **Imagining**. **Imagining** means spinning out ideas and being open-minded about what is possible in anything. If you are a person who learns

from other people in the **Experiencing** way, you learn from what they think and say and how they say it. Also you learn from knowing what they've been through that has brought them to think the way they do. If you like to watch people and think about them and make judgments about them, you may be the type of learner that can be creative and have many new ideas on your own.

If you are a thinker who sees yourself between **Observing** and **Thinking** you probably are someone who plans well, i.e., into **Planning**. You like to create models and scenarios. Probably you like to play games. You're patient and like to come up with theories and test them. If you are this sort of a learner, you will be strong and capable and be able to keep your cool when others won't. This is a great strength.

Between **Thinking** and **Experimenting** are things like **Problem-Solving, Deductive Reasoning**, being **Logical** and **Defining Issues**. Here you are like Sherlock Holmes, gathering evidence and making rational deductions as you move forward. If you're like this, you are both active and thinking at the same time. Imagine the possibilities of that!

Between **Experimenting** and **Experiencing** is **Risk Taking**, **Initiating** and **Leading**. It's also the area of **Adaptability** and **Practicality**. Do the best leaders come from this learning space? Very possibly. It may will be the essence of leadership is the ability and will to act and to adjust to reality as you do so.

Certainly all learning areas can produce leaders. Yet the learners who rely on **Experimenting** and **Experiencing** tend to be the ones that become the leaders like Darwin Smith.

How do you learn more about your abilities as a leader? One way is to construct a learning plan. Here's a very simple one:

Learning Plan

Construct a Personal Mission Statement

1. What do you wish to become both professionally and personally?
2. What do you want to do for yourself? For your family? For your community?
3. What makes you unique? How can you use that uniqueness to accomplish your goals?

The Plan

1. Make a goal to accomplish this semester
    a. *Develop action steps*
2. Make a goal to accomplish this year
    a. *Develop action steps*
3. Make a goal to accomplish in five years
    a. *Develop action steps*
4. Make a goal to accomplish in ten years
    a. *Develop action steps*

There are more in-depth things you can do to learn what kind of leader you can be, but the core thing to do is put your thoughts down and try to act on them. Even if you don't accomplish the goal you set out to, you've done something important because you've found it wasn't a goal that worked for you. It really takes doing things to discover what you're good at. If you don't want to do something, then you probably shouldn't make it your life's work.

In this section we have learned some of the basics of leadership and how they apply to us and also how we may apply them to our lives. It's important to say again that we all are capable of leadership and all are leaders of at least ourselves. It is also important to say again that we do not all have to be leaders. Still, understanding the concept of leadership is core to understanding business. Business is often amoral and confusing. Sometimes it takes a leader to see the smart and/or right thing to do, to have a vision that takes us all where we ultimately need to go.

"Beware of geeks bearing formulas."

Warren Buffett

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FINANCE

It was once pointed out to me that everything a business was could be devolved into money. The reason why this is true and why it's important is that a business is a money generating entity. It's other things as well obviously: a maker of medicines, a builder of machines and even a place that educates kids. But in its most formal sense and really in the way that allows it to survive, it is a generator of revenue and profit. If a business doesn't generate profit it will die, unless for some other reason it is kept alive by money coming from somewhere else. Money is a business' life's blood. Finance is the science that studies how that blood circulates.

You need money to start and run a business and it has to come from somewhere, either from you, your friends or people you enlist who can become either bond holders (people who loan you money) or shareholders (people who buy a share of your company). Also, of course the money that runs your business can come from the earnings of the business itself. After you have the money, what that money is spent on can be anything relating to the business itself or its owners, i.e., you can spend it on the business or on yourself.

Accounting is different from finance. Accounting is the record of what money is spent on. Finance is generally more forward looking and accounting more backward looking. Financing is part of strategy. Accounting is more of a post mortem. It can teach you things but it's there mostly so you know where you've been and how well you're doing. Accounting is something you need to trust, which is why accounting standards are so rigorously enforced and why, when there is a breach, it is often big news in the business world.

Finance presupposes a world where everything is constantly in flux. In order to really get finance you have to get the idea that the world is a fluid and constantly

changing place and that the idea of something's value is also fluid and constantly changing. This is true even for currencies. For example, a gallon of milk in Britain (if you were to buy it with American dollars) may cost $2.00 today and $2.34 tomorrow, not because the cost of producing milk went up but because the value of the dollar relative to the pound went down. Now, obviously you're not going to order milk from London when you live in New York City, but if you're a big company and you buy goods from a city in England, the cost of those goods may rise a great deal if the value of your dollars is suddenly a lot less compared to pounds than it was yesterday.

Why does this happen? Because pounds, dollars, milk and crude oil are all for sale. People buy and sell dollars and trade them for other currencies depending on what they think people can buy with that currency or what they think someone else will think they can buy with that currency.

The Time Value of Money

This is an extremely important term in finance. It means that a dollar today is not just worth more or less than another currency across the ocean, it's also worth less than a dollar a year from now. Why? Well, for several reasons. One is inflation, which means the value of money goes down because there is more and more of it in an economy. However the most tangible reason a dollar today is worth more than a dollar in a year is that you can use it today instead of a year from now. There is more value in having something now than later. That's actually one of the first things they tell you in finance: what you have is more valuable than what you will have.

Such being the case, in order for you to give up that choice, i.e., in order to get you to give up your money for a year, a bank will offer you a premium, which

they call interest. They will pay you a percentage of your money to hold it for you so they can spend it making money for themselves (they loan it out to other people and charge them a higher interest rate than they give to you and make money on the difference). This leads to another reason why a dollar today is worth more than in a year. The dollar you hold today will be $1.05 in a year if you put it in a bank, so the dollar someone gives you in a year is by definition 5% less than it is today, i.e., 95 cents.

So let's look at the time value of money more "schematically". It works like this: I put a dollar in the bank and it earns 5% interest every year. Here's what happens to the dollar over six years:

YEAR	**0**	**1**	**2**	**3**	**4**	**5**	**6**
	\$1.00	\$1.05	\$1.1025	\$1.1576	\$1.2155	\$1.2763	\$1.3401
Interest		$(1+.05)^1$	$(1+.05)^2$	$(1+.05)^3$	$(1+.05)^4$	$(1+.05)^5$	$(1+.05)^6$

Formula: $(1 + r)^t$

So, in six years your dollar has become $1.34. Now, say you started with $1,000.00. You would end up with more than $1,340.00, which means your money would have gone up 34% in six years. Not bad! This is what is known as "compound interest". Each year your dollar grows by 5%, which yields you 5 cents and then that 5 cents itself will grow by another 5%. The interest you make in the first year becomes part of the money that is generating the interest. That's why in the formula the .05 added to 1 is raised by an exponent equal to the number of years the interest has been generating. First you have $1, then you add 5% (5 cents) and you have $1.05. Then you multiply that by 5% (which you do by multiplying 1.05 by 1.05). And you keep doing that like so: (1.05) x (1.05) for year 1, (1.05) x (1.05) x (1.05) for year 2 an so on. The (1.05) is multiplied by itself once in the first year, twice in the second, three times in the third, etc.

I said the bank will pay you 5% to save your money with them. Actually it may be less than that for banks now, but the point I want to make is that the rate you get from a bank is riskless. You will get your money no matter what, even if the bank closes because the federal government insures bank savings (they think it's a good idea for people to save money so they give you an incentive to do it in insuring the money). If you invest in the stock market however... Well, you know the answer to that, don't you? Everyone has seen the stock market rise and fall a lot. It is decidedly not riskless. Investing in anything that's not riskless implies you should get a return higher than the riskless rate the bank will give you. Otherwise why would you do it? That's basic common sense. And it's also the core of finance.

People invest in companies to get higher returns. They invest in other things, too as said: corn, soybeans, oil, gold, coins, stamps, art, etc. These can be risky investments (some more than others) but the thinking is the same for all, i.e., that if you're smart and pay attention to what you're doing, you'll probably do alright. That's why investing is so attractive to some people. They figure, if they're smart, they'll do better than someone else might.

If you run a business you get money from several places and most if not all of these sources require a return on investment, i.e., a fee for giving you money. That fee (what finance people call a "return") has to be higher than the riskless rate they could get from a bank, otherwise they'd put their money in the bank. But there's more to it. While the rate needs to be higher than the bank, it can't be so big that the company makes no money, and it has to be a rate that the investor can see makes some sense. So, how is that return calculated? How does a company decide how much of a return it has to give to its investors in order to entice them to invest? And how do investors know that the company is creating

a fair rate that will work for everyone? This rate of return investors get for their money is referred to in finance as the Cost of Capital. The Cost of Capital can be computed in a number of different ways, but essentially it is calculated based upon the amount of money that has been already put into a company through equity or debt. Let's talk a little about these things.

We know debt as loans or bonds (a bond is another word for a loan or a specific kind of loan). A company can take out a loan from a bank or issue bonds that you or I can purchase. When a company issues a bond, it’s saying it wants to borrow your money and will pay you an interest rate higher then the riskless rate for that privilege. Usually bonds are issued in multi-year increments, as in a 10 year bond or 30 year bond. The bond will pay you a coupon (an interest payment) at regular intervals, and then pay you the full amount of your money after the years are up. So what the company is basically doing is acting like a bank, holding your money for a long time, paying you regular interest and then paying off the lump sum at the end. Bonds tend to be less risky than other types of financing and so the returns are smaller. People like them because they’re secure. One of the other reasons why they’re more secure is that debt holders are always first in line to collect their money when a company goes bankrupt. Stockholders are last.

One of the main reasons why companies like to borrow money to finance what they do is debt is tax deductible. You may have heard the term "tax shield" at some point. Well, debt (a loan) gives companies a tax shield of up to 35% in the United States. What that means is the interest the business pays on the debt is tax deductible. Here's an example of how it works: Imagine you make an investment of $1,000.00 which will return $1,100.00 at the end of one year. Let’s say there is a tax rate of 20% on the money you make, i.e., your return. At the end of the

year, you will have $1,080.00, which is made up of your original $1,000, plus $100 income and minus $20.00 in tax due to that 20% tax rate. Accordingly, you earned a net income of $80.00, or 8% return on the capital you invested.

Now consider that you have the opportunity to borrow $4000.00 at 8% interest, which is the same rate of return on capital as you got with your own money. You still have your original $1,000.00, but now you also borrow $4,000.00 and add that to the $1,000.00 giving you $5,000.00 which you put into the same investment as before. Assuming the investment returns the same 10%, you will earn $5,500.00 (5 x $1,100.00). You will have your $5,000.00 back plus $500.00. If you repay the $4,000.00 loan and the interest on it (at 8%) you will pay $4,000 + $320.00, leaving from your $5,500 a total of $180.00. Now that has to be taxed at 20% meaning your tax will be $36.00 leaving you with $144.00. See what happened? You invested $1,000.00 of your own money and got $144.00 back whereas before you only got $80.00. Now instead of an 8% return, you got a 14.4% rate of return.

The trick is the government is only taxing you on the $180.00 not on the full $500.00. If it taxed you on the full $500.00 then you'd pay $100.00 ($500 x 20%) in tax and end up with the same $80.00 you had before. The tax shield saved you $64.00. This then is the reason companies use debt to finance their investments. The $320.00 you paid in interest gets deducted from the $500.00 income you earned in the eyes of the government. It's thus a tax shield.

The other investment source besides debt is equity. Equity means ownership in the company. Companies sell parts of themselves in shares of stock. When a company raises money this way it usually has to offer fairly high returns. The reason is that investors are taking a larger risk since the value of their shares is

subject to the whims of the market. Also the shareholders are last in line if the company goes bankrupt and possibly will recoup nothing for their loss.

Why does a stock go down? The same reason it goes up. It's the perception of its value people feel who hold it. Remember value is a fluid thing. It's always changing. People and companies buy and sell stocks as well as commodities and all the other stuff. If a stock goes up, you may want to sell it thinking it might go down tomorrow or you simply need the money today because you need cash to pay a bill, or you want to pay a bill today rather than be charged interest if you wait until tomorrow. Also you may perceive the stock to be of less value than it is selling for. Maybe you've read the company's annual report and you see something in there that gives you some doubt about their strength or you've heard that people aren't going to be buying the product the company makes in as large numbers in the future. You might have any number of reasons for feeling as you do. The point is that stocks are risky because their value is more fluid. Generally a good company will maintain its value. But there are many things that go into determining that value and it can be very changeable.

Let's look at Google as an example. They have high profit margins right now and their stock, as I write this, is trading at $611 a share. Last July it was down to $430. Why did it change so much? Lots of reasons, but one of the main reasons is that it is a high tech company that functions off its ideas. It doesn't have a lot of real "stuff' in it of value other than smart people who do innovative things. That is value (obviously) but let's just say they went bankrupt tomorrow. There'd be very little of any value to sell to recover losses. They have a few buildings and a lot of computers, but that's it. If it was an airline, there would be planes to sell off and make several millions of dollars from. Google has very few of what are called hard assets. No tech company really does. That's part of the concern about them

and why their value can change so much. As long as they're regarded as valuable for their ideas and as long as they show profits, the market will value them. But they'll be volatile. You can count on that.

To give a quick example of a non-volatile stock, we might think of a utility company. A utility company supplies power, gas, etc., and you can pretty much be certain the demand for the product is going to be there. And you can be fairly certain that those big generators and power lines and so on are going to be worth some money if, God forbid, the company were to fail. But it won't fail. Utilities are one of those companies you invest in if you want consistent, safe returns. They won't be big but you're risk isn't big so why should they be?

In fact, as an aside, you can see that some tech companies are well aware of how volatile their situation may be. Microsoft for example. Microsoft has never taken out a single loan to finance itself. They've done it all with equity, that is with shares sold. So they have foregone the benefits of the tax shield. This is because they realized from the beginning they were in a risky field and debt was a bad thing because of it.

So it makes sense that when a company decides to do a project, it figures out how much the project will cost and then it adds to that cost how much the financing of the project will cost. Since the money itself costs money, that expense is a part of the equation.

Capital Budgeting

Capital budgeting is the planning companies do in order to accomplish what they want to do, like buy new manufacturing plants, a new fleet of planes, etc. Usually Capital Budgeting involves large projects. Daily operations tend

to be expensed out in year-to-year fashion, like the expense of having a work force. It's just there as a fixed cost. You don't plan for it as you would buying a big new building or creating a new product. Capital Budgeting is part of the planning used to determine whether long term projects are worth pursuing. There are several methods of capital budgeting or assessing the value of a project that companies use. They go by names like Net Present Value, Internal Rate of Return, Adjusted Present Value, Book Value and more. Let's look at Net Present Value.

Net Present Value (NPV) is a standard method for using the time value of money to appraise the potential profitability of a project. With NPV, you take the initial outlay of funds necessary for a project, say $1,000,000 and you then calculate how much the project will return to you over the next however many year. Then you use that time value of money and "discount" what the returns will be over that time and match that with your outlay to see if you make a profit.

Now the discount rate you use is a very important part of this equation. We saw an example of an interest rate of 5% compounded year after year. Conversely when you discount a project you figure out what's called a discount rate. It's like an interest rate except you divide by it instead of multiplying. You divide whatever the dollar amount is you expect to make in that year with your project by that discount rate. The discount rate is what it costs your company to get that money that you're making. In other words as you're making money, you're paying out money as well because the investors who gave you that original $1,000,000 demand a return on their investment every year. Remember the money companies use to finance projects comes from equity or loans (bonds). Each of these sources costs money to the company and that cost is used to discount, i.e., take value away from the money made on a project.

Here's a new term: The weighted average cost of capital (WACC).

Look at this equation:

$$WACC = \frac{E}{D+E} R_E + \frac{D}{D+E} R_D \; (1\text{-}T)$$

You can see E and the D stand for equity and debt and you can see they are divided by their sum, meaning you determine the average of debt to equity and vice versa (60% to 40%, 34% to 66%, etc.). Now, see those things they're multiplied by? R_E is the rate the company pays out for its equity (often determined by the amount of dividends given to stockholders; for example if a stock sells for $20 per share and has a $2 per share dividend, it means your cost of equity is around 10%. The rate of debt is easier. It's just the rate you pay your bond holders or the rate you pay the bank for your loan. The 1-T in the equation stands for the tax rate you pay. Really the T does but subtracting it from 1 allows you to create a coefficient that will properly reflect your savings from the tax shield we mentioned earlier.

Now there is some extra figuring that needs to be done when calculating the cost of equity to a company. This formula is called the dividend capitalization model:

$$\text{Cost of Equity} = \frac{\text{Dividends per share for this next year}}{\text{Current Market Value of the Stock}} + \text{Growth Rate of Dividends}$$

Like we said, if a stock is trading at $20.00 per share and paying a $2.00 dividend per share (what they pay you each year for owning the stock) and growing at 5% , then you'd require $2.00/$20.00 + 5% = 15% return for any money you'd invest over the next year. So this company figuring out what it needs to make on a project is going to use 15% as its cost of equity in the discounting of that project.

Now we have our rates, so let's determine our weighted average cost of capital. Let's say we have $10 million each of both equity and debt.

$$WACC = \frac{E}{D+E} R_E + \frac{D}{D+E} R_D \ (1-T)$$

$$= WACC = \frac{10m}{20m}(0.15) + \frac{10m}{20m}(0.12)\ (1-0.35) =$$

$$= WACC = (0.075) + (0.039) = 0.114 \text{ or } 11.4\%$$

Let's say the project will earn you $200,000 the first year, $300,000 the second, $500,000 the third and $400,000 the fourth. The NPV equation looks like this:

0	1	2	3	4
	$\frac{\$200{,}000}{(1 + 0.114)^1}$	$\frac{\$500{,}000}{(1 + 0.114)^2}$	$\frac{\$500{,}000}{(1 + 0.114)^3}$	$\frac{\$500{,}000}{(1 + 0.114)^4}$
-$1,000,000 +	1.114	1.241	1.382	1.540
	$175,439 +	$402,900 +	$361,794 +	$324,567

-$1,000,000 + $1,264,700 Leaving positive cash flow = $264,700.

Therefore you should do the project.

One more note. You can have several projects possible and compare their various NPVs and if they're all positive you might just pick the largest one!

Beta

A beta is an interesting thing. It's a number that measures risk. It's created by observing the relationship between a single asset or stock or something of value and a group of other things of value. It measures how the value of the one changes over time compared to the value of the group as a whole. You can see how that might be advantageous in determining the value of a stock in the stock market. Does that stock go up as the market does? Does it go down? That might determine whether and when you buy it. Normally, you find individual companies have betas of 0.81 or 1.2.

Sometimes they're negative. Measuring the one against the group is called looking for a "covariance".

How do you calculate a beta?

It's not hard to calculate a beta, but it is a task nonetheless because it requires a lot of computing. Here is the formula:

$$\beta_a = \frac{\mathrm{Cov}(r_a, r_p)}{\mathrm{Var}(r_p)}$$

Here "p" stands for all the assets in a portfolio and "a" stands for the individual asset. You could substitute all the stocks in the stock market for "p". If a beta is positive it means the individual asset is going up generally as the market does and if it is negative it means it's going up as the market goes down. So what might be the beta for various things? You can actually intuit a few just by knowing the nature of the market and the economy. For example, a company that sells cheap goods might have something closer to a negative beta for they do better when the economy in general does worse.

A beta can be used in what is called the Capital Asset Pricing Model (CAPM). This is another way to determine the cost of capital.

$$Ra = Rf + \beta\ (Rm - Rf)$$

β here is the beta or covariance of the asset. What you may recognize is this is the equation for a line $y = mx + b$, where "m" is the slope determined by the beta. It's a constant. The beta's a ratio so it is by nature a slope. "y" is the rate you seek, i.e., your cost of capital. "m" is the beta, "x" is the difference between the market and risk free rate (the risk free rate is like the starting point, i.e., a

zero, so the "x" makes sense in that light. The "b" being the risk free rate again is also a constant because it is fixed. Thus the beta determines how high the slope on the "x" axis will be and thus determines and rate commensurate with the amount of risk inherent in the beta. If the beta was 1 then Ra would equal Rm. If it was 0 then Ra would equal Rf because the stock would be riskless. If there's no variation then there is no risk.

The weighted average cost of capital and CAPM are two ways to determine the return on an investment. Really they are ways to determine the value of an asset. Let's talk a bit more about value and valuation.

Valuation

Valuation means how much something is worth obviously. In business it can mean what is the present value of the cash flows the asset will bring. This is called an intrinsic value. Present value, as we've seen, means the value today of all the money an asset (a company, a building, a product, a movie, etc.) will bring in over its life. When we calculate present value we do just what we did when determining NPV. This is because when we look at present value of future money we know that a dollar today is worth more than a dollar a year from now, just by definition (we could get risk free interest for it in the bank, right?)

Another way to calculate the value of a company is to do what's called relative valuation. Relative valuation is simply looking at an asset's value compared to other similar assets. If a company around the same size and in the same general business as another one sold for X dollars then the company you're looking at will probably be valued for around X dollars as well. The NBA, NFL and Major League Baseball use this method when making contracts with players. So and so pitcher got this much money, accordingly so and so other pitcher with a similar record should get this.

A third type of valuation is called a contingent claim valuation. This means something doesn't have value until or if something else happens. One example of such a valuation is known as a call option. A call option is often an incentive given to a CEO of a company. If under his or her tenure, the stock price goes above a certain level he gets a bonus, which usually means the ability to buy the stock at the price it was when the call option was made, i.e., when the CEO started. A less obvious kind of contingent claim valuation is an oil field that hasn't struck oil yet. In either case you're valuing a possibility. In one sense every valuation is simply a possibility, but a contingent claim is more obvious.

All valuation models assume one thing: that markets make mistakes but eventually correct themselves. In other words, the reason you try to value anything is the belief that there's value out there someone else isn't noticing and you are (you're looking for bargains). You buy and eventually everyone else sees the value and suddenly you've got something that's worth more than you bought it for.

Futures

It's important to understand the concept of a future if we're talking about options because futures are a very close cousin of the option. A future is something that developed a long time ago when farmers and store owners started making deals to buy and sell corn, wheat and other things. Basically a future was an agreement between the farmer, the seller and the buyer, the store that they would transact at a certain date at a certain price. They would do this because it was very difficult to run each of their businesses not knowing what that price was going to be. If the price was set they could plan better. They both were asked to put up some money in front in good faith.

Now over time that relationship yielded a futures market. What that means is there are deals existing where so and so is going to buy 10,000 bushels of soybeans at $5/ bushel (just to say) on September 1st. that means that he will pay $50,000 on that date for the soybeans. Maybe the buyer is Green Giant or some such company. Now what if it's May, four months before September and suddenly there is a major source of soy beans from some other part of the world no longer available. Suddenly the price of that future, that 10,000 bushels of soybeans at $5/bushel on September 1st might be considered a great value. What the futures trader will do is buy the future and see if the price goes up.

If it does, then he can sell it back and collect the profit. Now this is made easier by allowing the futurist to buy on margin. That is pay just a little and get a loan for the rest. He holds on to the commodity for a short while until the price goes up and then sells. He collects his money and goes home.

Finance is a complicated and strategic part of a company. It connects to every other part of strategy you do and can make your life much easier or harder depending on circumstances and how you do. It's no wonder, too, just why so many intelligent people go into the field. You can make a lot of money and it's pretty interesting work. Drawbacks are that it's very demanding and very stressful. Like much of business itself, it's about trade-offs.

BUSINESS SCHOOL IN A BOX

LEADERSHIP
FINANCE
ACCOUNTING
STRATEGY
MARKETING
ECONOMICS
VALUES

ACCOUNTING

Accounting may seem terrifying in its complexity or in its sheer boredom. The truth is, it is essential to any business and those who don't do it well not only waste money but are open to theft since only through accounting can you really get a picture of what is where in a company. After all, as was stated before, in some definitions a company is really just money turned into different things. Accounting is all about that.

Accounting breaks into three categories: financial accounting, managerial accounting and tax accounting. We are going to focus here mostly on financial accounting. As stated, financial accounting exists to provide a snapshot or a moment in time for a company that shows its stakeholders (share holders, bond holders and owners) as well as others where the company stands. It is important to note right off that, as seemingly impenetrable as an accounting report is (called either a 10K or annual report), it can show you a great deal about a company. You have to look at all the parts of the report and really analyze them.

The first part is called The Balance Sheet. A Balance Sheet is so named because it balances two things (actually three, but you group two together). The three things are: assets, liabilities and shareholder equity. The formula for accounting is: A = L + E, or assets balanced with liabilities and shareholder equity. Now what does all that mean? Essentially assets are things that you own. Liabilities are what you owe and shareholder equity is also what you owe (to your owners). Liabilities are that which is owed to the people the company buys things from to do its business including the people who invest in the company. The company essentially buys money from them.

Why do they have to balance? Because that's how accounting works. It's a system of balance. You bought this and it cost that, so that and this equal each

other, right? You put in $10,000 for this company and so it owes you that $10,000. It's not going to give it to you anytime soon since it needs that money to run, but it does owe it to you.

Here's a simple Balance Sheet:

ASSETS		**LIABILITIES**	
Cash	$12,000	Bank Loan	$40,000
Inventory	95,000	Owner's Equity	80,000
Other assets	13,000		
Total	**$120,000**	**Total**	**$120,000**

Now there are actually many more things that make up a Balance Sheet typically but this can give you the basic concept. Now the next part of the accounting record is called the Income Statement:

Income Statement	
Sales	**$10,000**
Cost of goods sold	-2,500
Gross margin	**$ 7,500**
Other expenses	-5,300
Profit before taxes	**$ 2,200**
Tax expense	770
Net income	$ 1,430

Here you see what you make—the money you get in sales—is listed along with the money you spent to make that money. This can get a little confusing. Try thinking of it like this. Your assets, the things on the Balance Sheet, are the immobile things: buildings, machines, property, your inventory, your basic materials needed to make your inventory, etc.. The Income Statement is concerned with the things that are more mobile, that move and change day-to-

day, like your expenses (the money you pay your employees and the money you pay the government (taxes) and the money you pay for the stuff you sold (costs of goods sold). And, yes, this gets confusing because we already mentioned your inventory, which is the product that you sell. So, let's try to tell a story to make all this clear.

You have a tire company. You buy rubber from a rubber making company and your company makes it into tires which you sell to tire stores. Okay, so what are your assets? Your assets are first your cash, which is the money you have in the bank. The rest of your assets are made up of the tires you make, the manufacturing plant you make them in, the rubber you use to make the tires and whatever chemicals you use to process the rubber you make it into tires. Also your assets are the land you have your company on, and the office building your company managers work in. Finally, your assets are things like the money you haven't been paid yet by your customers. This is called "Accounts Receivable". Also included in your assets are any loans you may have made to a client that have not yet been paid back. Have you ever financed a car from a car company? Same thing. And finally your assets are your prepaid insurance. An insurance policy is an asset because it can generate money for you.

Now your assets can get a little complicated because even though their mostly immobile it doesn't mean they're not changing, at least a little. Your buildings and machines are actually getting a bit shoddier every year. So they are depreciating in value. Now accounting is a bit odd about that. There are different ways that things depreciate, or different ways you, as the business owner can claim you want your things to depreciate, but ultimately things like buildings and machines depreciate in value because they get used up.

What are your liabilities? They are your Accounts Payable, which is the money you haven't paid the rubber company for the rubber you bought. They are the bank notes payable, the money you still owe on that $10,000,000 loan you took out to buy that new manufacturing plant you desperately needed. They are your Taxes Payable, the money you still need to pay the IRS because you didn't have your forms prepared when tax time came. And they are your Accrued Wages Payable, the money you owe to your employees because their union just cut a deal with you to raise their salary retroactively so you owe them money for the last year which you have not paid them yet.

The part that you add to your liabilities, the "E" part, is of course called Equity, the part of your company you owe to your shareholders. Sometimes that Equity is given to shareholders as a stock dividend or it is re-invested in the organization, becoming known as Retained Earnings.

Assets and liabilities (plus Equity) will balance by definition since starting at square one a company cannot exist unless it buys everything that makes it up. But you may ask. If I bought a building for a $10,000,000 and PAID for it then I have the $10,000,000 asset and don't owe anybody anything. Not quite. That $10,000,000 building is owned by the company, or the company stakeholders since they own the company and company bought the building. The money that bought that ten million dollar building had to come from somewhere and so that's the balancing act of the Balance Sheet. It accounts for everything from what is to how it became what is.

Cash Flows

The final accounting statement we like to talk about is called the statement of cash flows. Cash flows always seemed an odd term to me. I kept visualizing

tons of dollar bills flowing through huge canals or pipes. Basically though cash flows are money that comes into the organization and goes out over a period of time. Now for your tire company that would mean the money you pay for things you get and the money you get for things you have or sell. But it's complicated because your cash flow is not just money you actually get and give, it's money that denotes the value of something now versus what it used to be worth. For example, if you have something depreciate, like a machine, that loss of value becomes a negative cash flow. On the other side, your inventory might grow in value because tires for whatever reason suddenly become very precious. That can be listed as a positive flow of cash into your company.

It's all meant to be a working system. Being able to understand each of the three major financial statements gives you power to actually see what a company is doing. It's important to read them all because if you just look at one you might not get the full picture of what is going on. You might be fooled.

Here's an example of what I mean. Let's say a company was a bit unscrupulous, and wanted people to think it was a little better off than it really was. They would want to show this in their annual report because that's what a lot of big time investors use to determine whether or not they're going to invest in a company. They might sell off some of their big machines they use to make their product and list the revenue from these as sales thus showing they made a lot of money that year. What this would also show was that they made those sales with fewer machines, thus possibly giving the impression they were more efficient. However if you looked at the cash flows, you'd see that there was a large positive cash flow in capital equipment. If you put two and two together and matched up the increased sales numbers, you'd see that they were selling the very machines that made the product that made them successful in the first

place. In other words you would be investing in a company that would likely not do as well the next year because they wouldn't have the wherewithal to do so. Why would a company do this? Well, a CEO might do it because if he made big sales one year he'd get a big bonus. How would he get away with it? Maybe next year they'd get into a brand new business and no one would care about what had happened the last year.

Here’s a very simple cash flow statement:

Cash flow from operations	**+10,000**
Sales (paid in cash)	+30,000
Materials	-10,000
Labor	-10,000
Cash flow from financing	**+40,000**
Incoming loan	+50,000
Loan repayment	-5,000
Taxes	-5,000
Cash flow from investments	**-10,000**
Purchased capital	-10,000
Total	**+40,000**

Managerial Accounting

So far we've just talked about financial accounting. There are two other kinds: tax and managerial accounting. Tax accounting I’ll leave to those who have no lives. Just kidding. But I’ll leave that alone for now to concentrate on managerial accounting which is interesting in that it’s really about organizing things. Managerial accounting systems give you potentially valuable information regarding the operations of your company. Managerial accounting is internally

based and meant for a relatively small group of users as opposed to financial accounting, which is meant basically for the entire world. Also, managerial accounting is variable in its scope and how it is done, in as much as each organization does things differently.

Managerial accounting is a tool or set of tools. For example, at a private school, you might want to know how many of your graduating seniors are going to colleges and how many of them are going to prestigious colleges. You would want to know this to advertise your school to prospective students. Or rather the parents of prospective students.

Figures that you use for your business are called "metrics". Metrics are data that is used for the specific purpose of seeing how well a company is performing. One good example of a metric is the one Southwest Airlines used to use. They would measure whether or not they were turning planes every 10 minutes. A plane had to leave every 10 minutes from one of their airport gates. If they managed to keep up that metric, they knew their business was functioning correctly. Now understand this in the larger context. If a plane was leaving every 10 minutes it meant a lot of other things were working right as well, but Southwest didn’t need to know those other things were functioning. They could tell just by the one metric. Southwest knew its strategy well enough to be able to hinge all of its data on the one metric. It freed them up to do other things.

Accounting, though often not the most exciting pursuit in the world, is crucially important. Accounting is what finally put Ken Lay and Jeffrey Skilling behind bars. Despite all the really nasty things Enron did in their existence, the only really illegal thing they did was not show losses on their accounting books. Enron had developed a methodology for buying and selling power generating

companies that made them immensely successful, so much so that they got arrogant and ventured into businesses which they weren't as good at. In the process of doing that, they created what they called subsidiary companies, companies that did not have to be listed in their annual reports by an agreement Enron made with its shareholders. Basically, the shareholders agreed that as long as Enron kept it's stock price at a certain level, they didn't have to tell them about any subsidiary companies.

When these companies did poorly, Enron would actually sell them to other subsidiaries they would also create, companies that the public still didn’t know were theirs. With all this cover up there were no losses in their own annual report. The fact that they were in effect using their own money to buy their own company and hide its losses was never known. How they broke the law was, when their stock price did fall below a certain level, they didn’t report the news on these subsidiary companies.

Another thing Enron did is a little harder to understand, but not illegal per se. They would make a sale of, say, electric power to a particular region and list the money they got from that sale as a "capitalization". That is they listed the sale as an investment in the company, as if the money had come from a shareholder. This made them appear like a bigger and stronger company, which made them more attractive to other shareholders.

Their accountant was complicit in all this. Their accountant was a company called Arthur Anderson. Anderson at the time was working for Enron in two ways. One, it was their accountant, obviously, and two, it was their financial consultant. Arthur Anderson at the time swore up and down that the two sides of their work with Enron were not related. But of course they were. Anderson

advised Enron how to finesse their accounting records, i.e., lie, to make their company appear to have greater value. The accounting side of Arthur Anderson turned a blind eye to it. Why you ask? Money. People were making a lot of money at the time, and a boom economy is the last place anyone wants to worry about the rules.

Actually, during the late 90s and early 2000s, there were many people who knew that the economy was poised for a major drop. They knew there was trouble ahead. Why didn't they speak up? Money. Aswath Damadoran of the Stern School at NYU calls this "The Theory of the Smartest Lemming". Basically it says that even if you can see you’re all heading off a cliff, when you're still making money, you figure you’re smart enough to get out of line just before you step off.

Fortunately most accountants are pretty honest. It’s hard work being an accountant and it’s not terribly exciting, but it can be satisfying to do something that is about truth. An honest and smart accountant is a valuable thing in today’s world. A smart and unscrupulous one is also valuable, but for a very different reason.

ORIGINAL
Stratego

BUSINESS SCHOOL IN A BOX

LEADERSHIP
FINANCE
ACCOUNTING
STRATEGY
MARKETING
ECONOMICS
VALUES

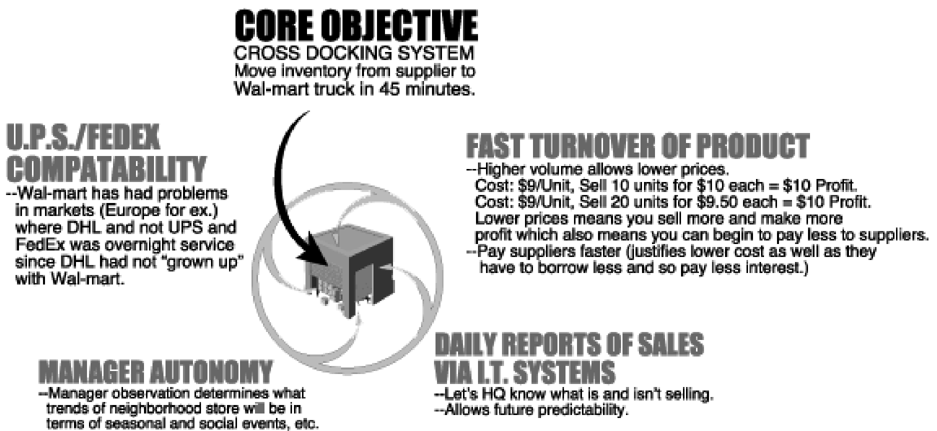
STRATEGY

What makes strategy so fascinating is that it combines all the other parts of business. It is also interesting to those who appreciate the inherent beauty of an idea and how it works. I will talk here ostensibly about two companies: Walmart and Southwest Airlines. In the last ten years there has not been a business school class that has not used these two as prime examples of successful business strategies. Other successful companies often talked about are Cisco, Microsoft, Johnson & Johnson, Coke and Burger King. There are others obviously. What these companies' strategies have in common is an engine that drives everything else in the firm. In business this is known as a core competency, and it is this which makes a business able to stand out.

Let’s start with Walmart. We all know this place, right? Many of us might think it’s kind of dull, appealing to the lowest common denominator, etc. And we'd be right to think that, but why do you think they succeeded so well when appealing to the lowest common denominator, i.e., price, when it is such an easy strategy to embrace? The answer is that’s not their strategy, it's the effect of it. Yes, Walmart is trying to be the low cost leader, but they're not doing it by simply charging lower prices.

There are professionals, CEOs, people who should know better, who think a strategy is something as simple as charging less. But that's silly. Charging less is meaningless unless you can figure out how to afford charging less and still make a good profit. How will you keep your costs down? How will you get the great volume of people you need to make charging less work? How can you build your operation such that you can continually afford to charge less? No strategy can work unless all its ramifications are thought out.

Walmart did think them out. And they came up with a key to a successful strategy in an area called logistics. What are logistics? Logistics is a business term that involves moving things from point A to point B, something businesses usually have to do. Walmart figured out a way to do this that was so much better than its competition, it became the giant sensation it is. And whatever you may think about Walmart as a company. you should respect the idea it had and how well it executed it.



See the term "core objective"? A core objective is very important. It involves regularly using and measuring a company's core competency. We know that with Walmart this involves logistics. Here's what happens: When Walmart gets a shipment in from, say, Procter & Gamble (shampoo, detergent, etc.), it arrives in P&G's trucks. It has to be taken off the trucks, stored in a warehouse, and then put on Walmart's trucks and delivered to the stores. This is true for large chains that have numerous suppliers. They have "docks" where merchandise is brought in and divided up to go to this or that store. Notice in the graphic above how it takes Walmart 45 minutes to move a package from the P & G truck to their

own truck? That's it right there. That's the killer core competency that wiped out K-Mart as a serious competitor to Walmart. Walmart figured out how to move merchandise from suppliers' trucks to their own trucks in 45 minutes. To get an idea just how short a time that is, by comparison K-Mart moved merchandise from supplier to their own trucks in three days! When Walmart developed that kind of logistical speed advantage, K-Mart didn't stand a chance.

Every bit of success Walmart has is based on this one competency. That ability to so quickly move product dictates everything else they do. And when you put it all together it’s a thing of beauty. You may not like Walmart for other reasons, and that’s perfectly understandable, but appreciate what they do well, because a great idea is a rare thing and when you see something take shape and succeed the way Walmart has, you ought to acknowledge it and perhaps use it yourself.

Now, first off, what does it mean when you can get product to a store faster than anyone else? It means you can charge less because you can more easily sell more. Say you have a product that costs you $9 to make. If you sell 10 units for $10 each you make a $10 profit ($100 - $90 = $10) If you sell 20 for $9.50 each you make the same $10 profit ($200 - $190 = $10). If you can supply product that people want to buy that fast and provide such a bargain, odds are you’re going to sell more of it. People will shop at Walmart because Kroger’s, K-Mart, etc. can’t beat the price. Sometimes not by a long shot and it’s all because they can move their product faster.

Now we mentioned earlier that a store can’t just have a low price strategy and succeed. Here Walmart is indeed using low price to bring in customers, but they set up a system that moved the merchandise so fast it made getting larger amounts to the stores cheaper than what the competition was using. Still there

was risk. Suppose Walmart hadn't gotten the sales it wanted? What would it do? Well, Walmart thought about that. Walmart trained its managers to be observant of their customers. Walmart would hire managers for their stores from the community the store was in with the idea that they would be best suited for understanding the ebbs and flows of consumer demand. Also, and perhaps more importantly, Walmart created a computer link up to all its affiliates that gave them sales information daily. This was so they could see what was selling and what was not, and so supply only the items that were needed in an amount their sales projected. They would thus have essentially no inventory.

No inventory saves money because inventory costs money to manage. The fact that Walmart could eliminate inventory was a big advantage for them. Moving product faster, i.e., selling it faster, also meant they could pay their suppliers faster (Procter & Gamble et al). And you know what? That's a big money saver for the suppliers because just about everyone in the business has to borrow large sums of money to run things (the loans we talked about in finance). Everyone borrows money to make their products and if you can pay back your loans faster, you pay less interest on them, so you save money.

Now one of the things Walmart does that gives it a bad name is it threatens its suppliers, puts pressure on them to keep lowering their prices to them, which Walmart can do as it more often than not becomes the supplier's biggest customer. This is called "buyer power". If Walmart is 50% of your business then you better try to keep it happy. Walmart is pretty draconian in how it deals with its suppliers, but if you look at how business is generally run, you can say that Walmart does pretty much what every company does, only better. Still there are many things Walmart could do better ethically.

It might be interesting at this point to try to understand business strategy by applying its ideas to something that many young people experience: trying to get into college. Say you are a student thinking about getting into college. Your core objective is not getting into college. Your core objective is making yourself the strongest collegiate candidate possible. Remember the core objective has to be something you can control and it has to be measurable, otherwise how could you tell you were fulfilling it? You can see your grades on this or that paper or test or whatever. You know your GPA and extra-curriculars, etc. You can control that. Your competitive objective though is to get into the school(s) you want.

If you think truly strategically, as a business would, you have to put all your options on the table at this point, everything that relates to making your goal happen. There are no rules here, nothing you can't do. This might be difficult because some of your choices for achieving your outcome might involve some unethical or at least uncomfortable activities. It might not feel right to have your mom call The Dean of Admissions, who is an old friend, to get you in. However, in business you have to look at all those options, questionable or not, and then decide what you can and cannot do. You are the only real moral authority. And any decision you make has to take into account that people's jobs are on the line.

Strategy and Tactics

As we've said before, a lot of business is about valuation. One of the ways we determine the value of a company is to understand how well it will compete in its business environment. To do this, we use a tool called Porter's Five Forces. Michael Porter, a Harvard Business School professor, came up with these five forces that determine the competitive intensity and attractiveness of a market. i.e., its potential for profitability.

The five forces are:

1. The threat of the entry of new competitors
2. The threat of substitute products or services
3. The bargaining power of customers (buyers)
4. The bargaining power of suppliers (sellers)
5. The intensity of competitive rivalry

The threat of the entry of new competitors

This is pretty self-evident. If a market is easy to enter then it's less attractive to be in. An example of a market that's not easy to enter would be the airline industry because planes cost so much (it's hard to exit for the same reason). An easy industry to enter might be fast food since set up costs are small. Businesses generally like to be in markets where entry is hard (barriers are high) and exiting is easy (barriers are low). The reason for the latter is that you want to be able to get out fast if things aren't going well.

The threat of substitute products or services

This is also pretty self-evident. The easier customers can replace what you sell them with something else, the less attractive that market will be for you.

The bargaining power of customers (buyers)

To Procter & Gamble, Walmart would be an example a company with buyer power. If a single buyer is such a significant part of your business, it can begin to dictate to you what prices you can charge it.

The bargaining power of suppliers (sellers)

Suppliers supply raw materials, components, labor, and services (such as expertise), etc. Suppliers can refuse to work with the firm, or charge excessively

for their product or service. Obviously they are important to the business process and can have a lot of power.

The intensity of competitive rivalry

Most people are well aware of this. Rivalry with other firms who do the same thing you do or close to the same is a major hurdle to competitiveness.

Besides checking the five forces, it is also a good idea to check two other categories: market size and capability of market growth. Each of these directly affects the potential for profitability. So when we analyze a business, we should use these categories:

Market size

Market growth

Threat of entry

Threat of substitutes

Buyer power

Supplier power

Rivalry

There is also another tool for seeing the attractiveness of anh industry called a SWOT analysis, the letters of which stand for Strengths, Weaknesses, Opportunities and Threats, but I think the SWOT analysis is a bit cheesy compared to Porter's Five Forces. Porter's is more in depth and makes you think more about what you're doing. SWOT's more of a short hand for what Porter's does, so I would say don't use it unless you're in a hurry. And, by the way, don't be in a hurry.

Porter's Five Forces analysis for Walmart

Market size
LARGE: The market for Walmart stuff is pretty much everybody.

Growth (Potential)
LARGE.

Threat of Entry
HIGH. It's easy to enter the food selling market.

(Ease of Exit)
HIGH. It's easy to get out of the business (which makes it attractive to anyone who wants to enter. Not a lot of risk if you mess up).

Threat of Substitutes
HIGH. Walmart sells mostly commodities. You can substitute tea for coffee..

Buyer power
HIGH. Certainly people have a choice to buy at Walmart or Giant Eagle, so Walmart has to win by cutting their prices.

Seller power
LOW. Walmart got sellers (Procter & Gamble, etc.) to use them and then began pushing down the prices they would pay as the controlled more and more of the market these companies had to sell to.

Rivalry
HIGH. Walmart competes not only with grocery chains like Giant Eagle, but also with Costco, BJ's, and even OfficeMax and Home Depot.

So all in all we have a pretty tough market to succeed in. If you were looking at Walmart as an investor from its beginning, you might just say: "Forget it." But then you'd see the core competency and their plan and you might change your mind. Walmart has always been a smart and tough business. And actually they show that most businesses, to stay solvent, tend to lose their principles. Did you know that when Walmart began it was their goal to buy only from American suppliers? They don't do that anymore. They are famous (and infamous) for buying cheap goods from China. Their initial principle died in the wake of competition, as many principles do.

Now, let's try something. Let’s look at getting into college in the same terms we just used to examine Walmart. Say you are strategizing about getting into a small, prestigious college:

Market size
SMALL.

Growth (Potential)
SMALL.

Threat of Entry
HIGH.

Threat of Substitutes
HIGH.

Buyer power
HIGH.

Seller power
MEDIUM: Sellers are essentially your school, the SATs, your extracurriculars and everything else that goes into your application to a college.

Rivalry
HIGH.

Here the key to your success is Seller Power. Most of you can’t do anything about anything else. Here your Seller Power is your grades, test scores, basically everything that makes you attractive to colleges. Seller Power normally means the power of people you buy from. Essentially you’re buying from the school, the SAT board and your summer jobs and internships. Your cost is the effort you put in to achieve your results. Better schools will demand better results, so to get into a prestigious school, you’ll have to pay a lot. To get into a school with less demand, you will need to pay somewhat less.

Every student works on this strategy every day. Of course there are other elements as well, as we mentioned earlier. Strategy can involve using legacy status in one school (your mom went there), or taking a class to get a better SAT score. It is said however that the main thing a student needs to do to be attractive to a good school is to distinguish themselves in an individualistic way, that is to be special for who they are. That's not an easy thing to do obviously, but it is interesting how this advice mirrors what we said earlier about core competency. The best businesses have something simple (but hard to copy) they do that makes them successful. Perhaps every one of us has the same thing.

What Southwest Airlines did that was hard to copy is an interesting story. They came into being after the airline industry was deregulated. You may not know that before the 1970s airline ticket prices were regulated by a government board. This was because the airline industry had started under such circumstances that the government had to be involved (it was risky and it was very much a part of the war effort before it was anything else). A board would tell Airline A that they could charge this or that for their tickets and fly in this or that area. The board balanced the different competitors. Flying was expensive and not often done by the average person. People drove more. Gas was relatively cheap until 1973 when the OPEC oil embargo started. By Jimmy Carter’s time there was a clamor to deregulate the airlines.

What deregulation did though was make it harder in many ways for the existing airlines. Delta, Northwest, United, all of these airlines had terrible financial problems and many went bankrupt because their model was not designed for a deregulated environment. They had learned to compete with one another in a different way, one that didn’t work in this new playing field.

Southwest however came along after deregulation and took the new rules to heart. In fact, Southwest did more than that. It said it wasn't going to compete with the other airlines, it was going to compete with bus lines. It was going to be a carrier for a niche market of people who would otherwise drive or take a train or bus somewhere. Southwest had a sweet spot of 375 miles as the longest one of their flights should be as they began their business.

Southwest decided that to be successful they had to give people flights absolutely on time and fast, one after the other, since they were really competing on convenience against something people could do already, i.e., drive. So they set up their entire system around making it so there were planes available every ten minutes. They did this the following way: They bought only 737s. The 737 is a good but unspectacular plane. It's not going to wow anyone. But they decided to only use those for the clever reasoning that if one was in need of repair you would have others to swap parts out of if you didn't just swap the plane. Also with only 737s the maintenance team would be the best in the business because that's all they would work on. Most airlines hire out their maintenance. They don't have their own team. Southwest did because it worked for their business model. They also had flight crews and pilots that were trained on the 737 so if one was sick, it was easy and quick to replace him or her. They also had flights leave on the hour. Why? It was easier for passengers to remember. They also designed their flights to load first come, first served. Why? So people would show up on time to get good seats. The whole thing was built around getting those planes filled and out of the gate every ten minutes. That was their core objective because they could measure that. If they weren't hitting their ten minute goal, something was not working. Also, they used computerized ticketing to cut down on red tape and paperwork. They made their flights fun by having energetic staff and basically they just made themselves a great success.

Oh, yes, and it didn't hurt that in the 90s they bought airline fuel futures at $25 a barrel. Back in the 90s, oil was dirt cheap and so Southwest bought futures, basically bought oil for the next then years at that price. They spent a lot of money but saved even more in the long run. The other airlines wanted to do the same thing but they didn't have the cash. When the price of oil closed in on $100 a barrel after the turn of the millennium, Southwest made out quite well.

So the point here is that a key to strategy is simplicity. In business it is generally true that the best companies are the ones that have a core idea which turns into a core methodology that drives everything else. Lots of businesses have hundreds of metrics they use to determine how well they're doing. The best have less than a dozen. So if you have a core talent or set of talents, using those to get somewhere is the way to go. The trick is to figure out what is the best way to use them.

Hungry Jack
Complete
Buttermilk
PANCAKE & WAFFLE MIX
2 49
Since Springfield 1947
Cornbread Mix
ADD EGG & MILK
1.49
Great for muffins too!
NET WT 15 OZ (425 g)
NEW!
6
PACKETS
JUST ADD MILK
READY IN 5 MINUTES
199
Pillsbury
MADE WITH REAL DATES!
Quick Bread
QUICK BREAD & MUFFIN MIX
Date
1 49
NET WT 16.6 OZ (1 LB 0.6 OZ) 470g
SERVING SUGGESTION
Pillsbury
MADE WITH REAL DATES!
Quick Bread
QUICK BREAD & MUFFIN MIX
Date
1 49
Compare & Save!
Quality and Value since 1930
"JIFFY"
Devil's Food
mix
.39¢
add egg and water
use JIFFY frosting

BUSINESS SCHOOL IN A BOX

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MARKETING

So, what is the point of marketing? We all pretty much know that. It's to give people what they want, or rather to tell them what they want. Marketing is as simple as placing an item on a shelf at a grocery store (at the market, right?). It's there for you to see with a label telling you what it is. No big deal, right? Marketing is just communication to put you in a position to spend money on something that a seller wants you to spend money on. There are as many different ways to market as there are to communicate since all marketing is communication, usually very well thought out and planned communication.

So how do we start talking about marketing? Well, what do you see when you go to the store? You see items on a shelf. Did you ever think about why you saw this or that item on the shelf and not something else? Did you ever wonder why one item was on a higher shelf than another? It's all marketing. It's all money being spent to get something to be seen by you in a particular way. Pricing, too, can be about marketing. Sometimes you have sales where an item is cheaper in order to get you into the store. That way the store figures you'll buy other items that you happen to see. In fact, sometimes it's hard to think about what isn't marketing. There're so many places it's used.

These days of course the rise of the Internet and social networking has made a huge change in marketing. We are living in a time where communication is really being redefined and the basics of marketing are being challenged as never before. We'll talk about that in a little bit.

Marketing and Psychology

Marketing and psychology have a very close relationship since psychology is a science of human behavior, desires, motives, etc. All of these are right in

marketing's wheelhouse. One of the best ways to think about marketing is to think how you prepare yourself for each day. You put on clothes to make a particular statement. Ways of dressing send messages. You may want to say you are happy, sad, moody, excited, stylish or anti-stylish. All of these looks send messages to people. You are in fact marketing yourself. You're not selling yourself per se, but you are transacting for something, even if it's just certain perceptions you want others to have about you. You are in effect competing for attention. It's not really thought of that way, but you can definitely see what you do as competing for attention and trying to define the perceptions of yourself to the people around you. Their attention to you becomes a kind of currency, particularly in an environment like a school or a job. Feeling good about your place in your group is a kind of remuneration for successfully marketing yourself.

You can see in the various social groupings people make with one another, cliques, gangs of friends, etc. a kind of targeted marketing. We begin to know what audience we want, and begin to tailor our look to that audience. Maybe we dress in goth style or wear letter jackets. Obviously we are still making statements to the rest of the social network, but our goal is to maintain that strong tie with our target audience. Most businesses want to build a relationship with their customers such that they, too, can get consistent attention, which, in their case means consistent business from a core group of buyers.

Marketing Strategy

Traditionally, strategic marketing planning was about understanding first what it was you were selling and then targeting the best market or markets to which you would deliver your carefully crafted message. Look at commercials. They're usually meant for a certain type of audience, whether it's young men

for a beer commercial, or older women for dietary supplements. The point is psychologically the marketer is trying to nab you where you live, to get inside your head and say: "You need this." You may or may not need whatever they're selling, but the point is they are trying to get you to think about it, to position their product or service in the part of your mind where you will think about it positively when you are at the point of making a buying decision to fulfill that particular need in your life.

Marketing has a lot to do with a company's overall business strategy. After all if you make and sell passenger jets, there's not much point in marketing to the average suburbanite, right? They're not going to have the money or desire to buy a 747. If you make airplanes, as Boeing does, you might want to have special marketing tactics directed at the US Government and the major airlines. These sorts of marketing attempts you or I likely would never see since they wouldn't be shown on TV. You might see them in certain magazines like The Economist or a trade journal the air force bigwigs might read. But TV wouldn't be worth their time.

Having reread that paragraph, I have to add something. You could see ads for companies like Boeing, but because they want you to consider buying their stock. Obviously it's not just planes they sell but themselves. If you watch "Meet the Press" or one of those types of shows, you might see ads for Boeing or Archer Daniels Midland or some company that doesn't sell consumers anything. Those ads are there to paint the company in a good light so you, the consumer, will consider buying their stock.

One more thing I have to add. There are cases where companies will advertise to consumers who cannot actually purchase their products but can influence others to

do so. Kids for example get sold cereal, candy and toys, but their parents have to buy them, so obviously these marketers are counting on the kids to do some of their work for them. Also, drug companies will advertise to people to whom they suggest "Ask your doctor" if such and such medication is right for you. I know several doctors who wish that never happened, as they are bombarded with requests from their patients for prescription medicines the patients really do not need.

Let's look at another example of marketing strategy: There's a company called Tassimo that makes coffee makers. These coffee makers are the single cup kind. You've probably seen them or maybe even have one. There are other companies that make them, too, Keurig for example. Tassimo's coffee maker is more expensive and it offers a quality product. It's a difficult sell though because people are used to coffee being easy and cheap to make at home. So what does Tassimo do? It advertises and markets itself not as an alternative to Maxwell House, but as an alternative to Starbucks. The president of Starbucks once said that they didn't sell coffee as much as they sold lifestyle. In other words, you go to Starbucks because you like how it makes you feel: smart, with it and hip. The coffee itself is fairly substandard as coffee goes. It's cheap. I know this because when I was in college I worked for a very good coffee importer and I learned what good coffee is. Starbucks jacks up the prices for all their drinks adding style that makes them fun, but the core ingredients are ordinary. They succeed via the accoutrements built around the coffee itself.

Tassimo's marketing thrust is to say that if you're going to spend a large amount of money on coffee, why not spend at home on this coffee maker? It tastes better than Starbucks and it's ultimately priced about the same per experience. Heck if you're going to Starbucks once a day you could be spending nearly $5 for coffee. That makes the Tassimo at least in the same ball park. Still it's been difficult for

Tassimo since it takes time for a new way of enjoying a product to be embraced by the public. It's just the way it is. You have to have patience to do something like this.

One thing I want to add here. When I say Starbucks wants to make you feel smart and hip, you might feel a part of you going: "Hey, I'm already smart and hip." And you may well be. One rather distressing thing about marketing is that it makes you view aspects of human behavior as if you were looking at mice. It dissects people and makes everything about them less human. But that's basically the drill. Marketing, like psychology and social science, takes our humanness and turns it into science.

You've all seen The Snuggie, right? Well, when that started, like many products that begin life as TV infomercials, there wasn't an actual product in existence, or rather, there weren't enough to actually sell them. Many times when new products are introduced, they are offered on TV for people to call in and buy. What happens next is people call in and order and the company figures out how well their product will do by how many calls they get. Then they call the people back and say the product is out of stock and they give them their money back. This is a sneaky form of focus group testing that is done often. Then suddenly the product starts appearing in stores with "As seen on TV" sign next to it. You've been educated and are now ready to consume. But you had to see it on TV first, and if a bunch of people hadn't called wanting to buy this product they could not actually buy, you would never see it again.

Marketing essentially takes three forms: You market either by the strength of the product or service, by its price or by the particular market you're going after. So you can either say you have the best product, the cheapest or the one that appeals

more to a particular group of people. Expanding from that, marketing goes into great detail to break down the demographics of various types of audiences. Are you black, white, female? Are you like others in your geographic area? How old are you? Literally every single thing that can differentiate you from another person or make you like them is thought about when a marketing campaign is planned. And all these things are balanced with product, price and target of the marketer.

There’s an old saying by a famous American journalist named H.L. Mencken: "No one ever went broke underestimating the intelligence of the American public." People are emotional, needy folks. We’re insecure, often scared, greedy, wanting things when we know we probably don’t need them. We’re flawed people and much of marketing is about taking advantage of that. Now that sounds bad, but doesn’t psychology do the same thing? Seeing a therapist makes you feel better, right? Sure. But a new pair of shoes might, too, or a vacation to the Bahamas. See, there is always going to be push-pull in the world between what you want and what you need. Generally, to make your life better, what you need to do is focus yourself on what you want and be smart and deny yourself things that aren’t helping you achieve what you want. Most of the time what you need is within you and nowhere else. Marketing will never tell you that. Ever. Marketing will always tell you that there are a thousand things that can assist you to get what you want and need. It can help you diet, get a degree, have children, have more hair, have a better marriage, etc. It's all about quicker ways to get to where you want to go. And, you know what? It may help. But it is more likely that marketing distracts people from the hard work of making themselves and their lives better.

Buyer Behavior

Buyer behavior obviously has a lot to do with marketing psychology. But the

real trick in understanding buyer behavior is understanding that you really can't understand it. You can do all the figuring, test focus groups you want and still be wrong. The world moves and changes at such a pace and with so many things influencing the directions it takes, that it's all but impossible to really make a good estimate of what will happen. It's much like trying to predict the stock market. People try and succeed sometimes but more often they fail.

Product Life Cycle

Another interesting part of marketing is how it looks at the process of its own existence. Every marketing campaign has a beginning, middle and end. Products actually go through a product life cycle (services, too). You see them generally go through these stages: Introduction, growth, maturity and then decline. You employ different marketing strategies for each stage. In the introductory stage you are at the highest risk since you're pumping money into something to get it introduced into the world without really knowing if it'll take. The growth stage is risky as well because you have to gauge your rate of growth properly. If you grow too slowly there's obvious trouble, but if you grow too quickly, it can be even worse. That's because growth involves so much potential change in how you make your product and get it to market. If you mess up when people want your product, they may not want it anymore. The maturity stage is when a product or service is referred to as a "cash cow", because, for minimal effort, it gives you a healthy return. Many products like Heinz ketchup existed in a maturity phase for a long time. When it was discovered that the product was beginning to decline, the company began to market new varieties of it. Nowadays we find that a lot of old brands are trying to refresh themselves with new versions.

Now some companies bring a product or a service to the maturity phase and then sell it off. They do this so they can put their money into a new product or service

that is just starting out and grow that instead. Some companies are actually better shepherds of mature businesses and will buy and house them under their umbrella (Johnson & Johnson is one such company as is Cisco). Venture capital firms generally buy start-up companies, looking to grow and then sell them to a Johnson & Johnson or GE.

One of the interesting things about the Internet is the interactive nature of marketing now. You may have heard the term Relationship Marketing. In Relationship Marketing, you establish a back and forth with your clients. They can visit your website and make suggestions to you about what sorts of products they want. Zazzle.com for example was a pioneering company letting people design their own clothes to sell to others. Zazzle built a community, while also gathering information on its clients. This is why you sign up for memberships in everything from Costco to Dick’s Sporting Goods. Getting an e-mail, a phone number and other demographic information from you is crucial for companies to figure out how to market to you.

Marketers are there to make a customer's life better, or easier by providing them with something that it’s easier for them to pay for than to do themselves (or of course get from someone else). If you’re selling shampoo, you’re first competing against other shampoos in your price range, then in your market focus (your type of client—women, athletes, etc.) then shampoos in general and then other types of soap that could take the place of shampoo. You have to put in front of you the entirety of possibilities someone could use to serve the need of cleaning their hair (some people use ashes and rain water) and then winnow down to what you can provide and to whom. It’s a connecting process and the businesses that are successful are the ones that do it well.

Once you're at this point you have to concentrate on the consumer, and try to understand their buying decision. How does a consumer make a buying decision? Let's look at an example. Think about the process of buying a morning cup of coffee. A morning cup of coffee is often an impulse buy impacted by when the problem recognition occurs (when you decide you have a need for coffee). Let's suppose the problem recognition happens during a commute to work or school. Once you recognize the problem, the next step is informational, i.e., you determine if you are closer to one coffee shop or another. Then you evaluate alternatives, comparing each type of coffee available at each shop. Of the two types available, one is better tasting and you've been there more often so it's more comfortable to buy, but the other has far stronger coffee, which might be an aid if you're tired that morning. A third alternative is waiting to have coffee at work or school. The coffee won't be as good there but it'll be free.

At the point of making the decision to go to one place or the other, a situational issue occurs: you consider whether there is parking at the store you choose (say it's a Starbucks with limited parking space). Also what comes into play at this stage are the attitudes of others. Your friends might think Starbucks is a corporate monster or they might think you're not cool if you don't go there. Sounds silly but decisions are made for these kinds reasons all the time.

Once you've made the purchase your post purchase behavior comes into play. Getting Starbucks might touch your aspirations of self worth, making you feel younger and hipper and more successful, while the other coffee might make you feel more calm, more controlled, more family connected. Ultimately buying decisions involve continually evaluating your place in the world, whatever that place is.

It was said earlier that finance was a continually changing landscape of value over time and geography. Marketing shares some qualities with that but differs in its focus on intimate levels of decision-making. Marketers really want to get into peoples' heads to figure out why they buy and don't buy. And if you begin to really do that to yourself, to analyze your own behavior and that of your friends, family and others, you'll begin to see just how much marketing is a part of your life. It's all a question of importance, like valuation in finance, only the valuation is happening for innumerable reasons having to do with personal foibles and changing loyalties and just your mood that day. Remember to market successfully means to first understand why you like something and why you would like what you're selling and what makes you the same or different from the people to whom you are marketing. Underneath it all, we are pretty much the same. The chore the marketer is to connect up ultimately with the customer and get them to feel that the marketer's service or product is properly and comfortably a part of their lives.

AN

INQUIRY

INTO THE

NATURE AND CAUSES

OF THE

WEALTH OF NATIONS.

By ADAM SMITH, LL. D.

WITH A LIFE OF THE AUTHOR,

AN INTRODUCTORY DISCOURSE, NOTES, AND

SUPPLEMENTAL DISSERTATIONS.

By J. R. M^c^CULLOCH, Esq.

PROFESSOR OF POLITICAL ECONOMY IN THE UNIVERSITY OF LONDON.

IN FOUR VOLUMES.

VOL. I.

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BUSINESS SCHOOL IN A BOX

LEADERSHIP
FINANCE
ACCOUNTING
STRATEGY
MARKETING
ECONOMICS
VALUES

ECONOMICS

As stated earlier, one of the most interesting things about economics is that it has a big interest in human behavior, but in a different fashion than marketing. Economics takes the large perspective of entire countries acting certain ways and the human race itself really. That's one of the things that's so interesting about it. It's an assertion of a Godlike authority over the actions of everyone. You, as the economist, get to sit back and say: "Everyone will do this if we do that." Or "Everyone might do that if we don't do this other thing." Also you get charts and graphs and formulas to predict human behavior. In typical math, formulas and graphs are less interesting because they don't mean anything beyond the abstract. But in economics they have a real meaning. They can determine policy. They can say whether or not a government will put millions of dollars into this program or that.

Now if you have studied economics you are probably aware of a couple of basic premises. The first premise is the cost of something is what you give up for it. In other words, economics is about choices and cost ultimately means choosing the braces over the vacation. Do we see everything that way when we make our choices? Economists might say we do, even if we're not aware of it. They might say that the fact that you don't think of something else you could get when you bought a particular thing meant you really didn't want that other thing that much. The second premise is that the cost of something that you make can vary from place to place. If I'm living in North America, I'm going to have an easier time smelting steel than if I lived in the Congo. Why? It's really hot in the Congo! It's too hot to consider doing certain kinds of major industrial development. However in the Congo harvesting certain kinds of spices might be cheaper since the weather is right, the land is good and the labor force is experienced at farming the spice. So harvesting a spice in the Congo means them giving up a small amount, whereas farming it in the United States might

mean we would have to give up a great deal. The United States doesn't have the endowment for it. Economists say that different countries have different endowments.

For us, mining and smelting copper might be a thing we do that doesn't cause us to give too much up. This is not just because we have the right climate, but because, once you do something for a while, you tend to get good at it. You begin to give up less to do it, i.e., it costs less. The same is true of the spice farmers in the Congo. These two situations taken together give us the best circumstances for trade. We can trade our steel for their spices and each of us is better off since their getting steel for the cost of spice is easy for them and us getting spice for the cost of steel is easier for us. Specialization makes everyone better off.

To restate: if a country is really good at certain things, they will continue to do them because the better they get, the less they give up. However in the process they tend to ignore things. That's why certain industries in the United States (automobiles for example) have lost workers. Other countries specialized better than we did, Japan for example. Economics says if workers are lost from a less tradable industry, they will eventually be hired by the more tradable one(s). Of course they will make less money, which is too bad.

Generally, economics teaches us there are reasons why some countries are rich and some poor. The basic answers for this involve geography and property rights. Countries that define property rights liberally and construct efficient institutions to protect and enforce them do better economically than countries that do not. Simply put, it costs money to hire protection so you don't get robbed when you bring your goods to make a deal. Also, geographically, it's harder to

build a factory on a mountainside or, as stated, in the Congo. Also it's hard to carry your goods through a jungle.

Utility is another concept economists love. The utility you get using a thing the first time is good. The second time you use it, it’s less, but added to the first it’s still more than using it once (think of the second cookie). The third time is still good, but now you’re thinking that maybe you’re eating too many. The fourth cookie is still good, but now you know you’re eating too much and you’re wondering also about your teeth. After the fifth cookie you stop. You’ve maximized your utility.

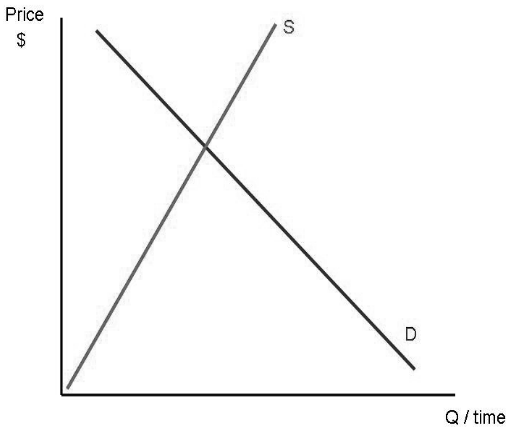
Utility is crucial to economics because it presupposes a world where you, as the consumer and the seller who sells you what you consume live in a kind of perfect balance. Supply and demand exist in an equilibrium where ideally the most utility is being exerted. To economists, utility is lost when a price is too high or too low or a product or anything that can be consumed is artificially made cheaper or more expensive by something other than market forces. This is referred to as interference with the market. It usually takes the form of something like rent control or a subsidy of some kind.

Rent control is something that keeps rents in an area from rising beyond a certain point. This has been done in cities like Boston to allow people who are not wealthy to remain in the city when rents rise due to an influx of more wealthy people. The rents rise because there are more people able to pay the higher prices. But the city government thinks that it's better for the city in general if the people who have lived in the city for a long time and who arguably give it its character can stay.

The economist looks at that and cringes. "Wait," he says. "If you artificially push down the price of these very desirable apartments you are lessening the economic utility for everyone." A $4,000 a month apartment cannot go for $1,000 because it will not be available to the people who can afford it at $4,000. They will lose that utility as will the seller. Someone who can afford $1,000 and has the right information and luck to get there first will snatch up the place and never let it go. Maybe it will go to an older couple who have lived in the city all their lives. Maybe that's good in one sense, but to the market you are denying the complete expression of the utility of everyone. Richer people deserve their slice of the pie, too, at least in economics.

There are other issues involved with this. If a property is forcibly devalued, as would be the case with rent control, the landlord will have less incentive to keep the property up, to keep it painted and its appliances new, etc. The overall quality of the place may suffer; it's value will not be properly expressed. It will not be, if you will, as beautiful as it could be or ought to be.

Now, the other term we used was subsidy. A government will sometimes want to support different sectors of an economy for political reasons. For example, farmers. America has a tradition of farming. It's something important to people for more reasons than making a living. Accordingly, the government has, at various times, gone about paying farmers (this is called a subsidy) not to grow certain crops. They do this so the supply of that crop in the economy stays at a certain level so the price stays at a certain level. If this happens all farmers can make out better in the long run (according to the theory). The big farmers who could flood the market with corn are paid to not do so in order to artificially keep the price up. According to economics that robs the lowest end corn buyers of their proper utility. That part of the economy is left out.



This Supply and Demand curve shows you that the supply of an item and the demand for it change over time via price. You'll note that supply begins at zero and demand ends at zero. The idea is that you start with nothing and build a supply of something as demand rises. Then over time the demand lessens. What you may not know is that there is an elasticity to supply and demand that varies from product to product. Elasticity is the ability that something has to change, how volatile it is. Interestingly, different goods (products or services) have different elasticities at different price points. That is the supply and/or demand of a good will vary more greatly at one place along the supply and demand curve than at another. What this tells us is there are limits in consumer to what a price is or ought to be for an item. A price can probably float around a certain level, but when it goes too high, demand will go down sharply. Similarly if it goes very low, demand can jump sharply. Normally this has to do with its price in reference to competitor pricing. If my price goes too much higher than my competitors, you'll stop buying from me and buy from them. If I go a lot lower than them, I'm essentially trying to push them out of the market. I'm taking a chance because I probably can't survive if I keep my price so low for long. I'm doing it temporarily to gain a lot of market share. Then I will bring my price

back up since you all are now using my product, and it's really hard to get someone to change once they have a brand they like.

As stated, elasticity means how changeable something is. This can apply to either demand, supply or price or any number of things the economist may want to measure. Elasticity of demand can be calculated using change in price and change in demand. Without going into the math of it, let’s say that since it's a ratio, we can call something elastic (demand) if the result of the ratio equation is greater than 1. This means that quantity changes more than 1 for a like change in price. It’s elastic because it changes by a greater amount than the price does. Contrarily, if it changes by less than 1, we say it is inelastic. If they remain equal, then we use the term "Unitary Elastic" to describe what is happening.

As a business person we care about elasticity of our products because the elasticity has a direct effect on how the price change effects total revenue. When demand is inelastic, a price increase raises revenue and a decrease lowers revenue. When it’s elastic, a price increase lowers revenue and a decrease raises it. How do you tell the elasticity of what you’re selling? Two simple rules: If there are not many substitutes for what you’re selling then odds are demand is inelastic. Gas for example. The price of gas does change, but the demand for it stays pretty consistent. Not too many electric cars yet.

Note though that as time goes by the chance of a substitute existing increases so your product’s demand will grow more elastic. Also if the cost of the product is small relative to the customer’s income, demand is probably inelastic.

Understanding Demand Curves, Product Surpluses and Deadweight Loss

One of the fascinating aspects of economics is that it visually shows us human behavior on a large scale. Remember earlier when I mentioned that economics

shared a lot with marketing in that it was interested in understanding human behavior. Looking at demand curves is one of the simplest ways of seeing this and understanding how economists see the world. To help with that, and to understand more of elasticity and the effect of an outside force on an economy, I have an exercise here. You don't have to do it. Just read and follow along.

Exercise

In the mid 1990s, the United States increased the minimum wage from $4.75 per hour to $5.15 per hour. The question is what happened in the market? Were low skilled workers better off because of the hike in the minimum wage or worse off? Let's see how we figure that.

At this time, at $4.75 per hour worked (the price of labor), 1,975,000 people received the minimum wage. These people worked an average of 26 hours per week. Economists estimated the elasticity of demand for low-skilled workers at 0.3, and the elasticity of supply at 0.1.

Hints: 1) Firms demand labor, workers supply labor. 2) Because the wage is $ per hours worked, the horizontal axis of your supply and demand model should not be in units of the number of workers. It should be in labor hours worked, so start by taking the number of minimum wage workers and multiply it by the average hours that they work to get labor hours worked. The analysis should be in labor hours worked.

In order to solve this problem you have to first use the information you have to calculate elasticities:

(Ed = Elasticity of Demand) (Es = Elasticity of Supply)

$$Ed = 0.3 = \frac{\%\Delta Qd}{\%\Delta P} = \frac{\%\Delta Qd}{\frac{5.15 - 4.75}{4.75}} = \frac{\%\Delta \mathbf{Qd}}{(8.42\%)} = \frac{\mathbf{(2.526\%)}}{(8.42\%)} = 0.3 = Ed\text{: } \%\Delta \mathbf{Qd} = \mathbf{2.526\%}$$

$$Es = 0.1 = \frac{\%\Delta Qs}{\%\Delta P} = \frac{\%\Delta Qs}{\frac{5.15 - 4.75}{4.75}} = \frac{\%\Delta \mathbf{Qs}}{(8.42\%)} = \frac{\mathbf{(.842\%)}}{(8.42\%)} = 0.1 = Es\text{: } \%\Delta \mathbf{Qs} = \mathbf{.842\%}$$

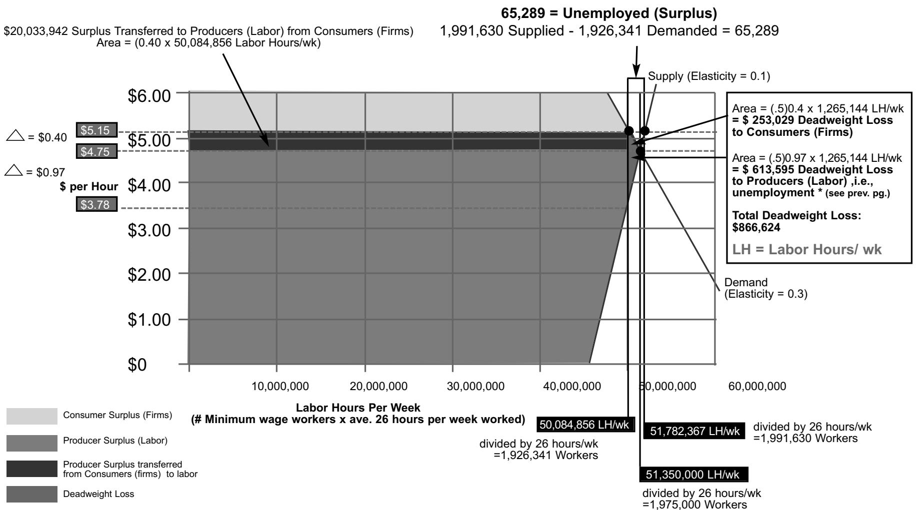
(Qd = Quantity of Demand) (Qs = Quantity of Supply)

$$Q2 = 51{,}350{,}000 \text{ Labor Hours: } Qd = \frac{Q2 - Q1}{Q1} = \frac{51{,}350{,}000 - Q1}{Q1} = \mathbf{0.02526} \quad : \mathbf{Qd1 = 50{,}084{,}856}$$

$$Q1 = 51{,}350{,}000 \text{ Labor Hours: } Qs = \frac{Q2 - Q1}{Q1} = \frac{Q2 - 51{,}350{,}000}{51{,}350{,}000} = \mathbf{0.00842} \quad : \mathbf{Qs2 = 51{,}782{,}367}$$

*Calculating deadweight loss to Producers (Labor):

$$Es = 0.1 = \frac{\%\Delta Qs}{\%\Delta P} = \frac{\%\Delta Qs}{\frac{4.75 - P1}{P1}} = \frac{\mathbf{(.02526)}}{\frac{4.75 - P1}{P1}} = .1 = \frac{\mathbf{(.02526)}}{\frac{4.75 - 3.78}{3.78}} \quad : \mathbf{P1 = 3.78}$$



= $ 253,029 Deadweight Loss to Consumers (Firms)

= $ 613,595 Deadweight Loss to Producers (Labor) ,i.e., unemployment of those employed at $4.75/hr.

= $ 866,624 Total Deadweight Loss

Add 432,367 LH / 26 hrs/wk = 16,629 people who either left school or something else to enter the workforce and were left unemployed. Raising the minimum wage from $4.75 to $5.15 took $866,624/wk ($45,064,448/yr) from the economy in deadweight loss, which was measured in labor production loss, i.e., unemployment ($613,595/wk) ($31,906,940/yr) and loss of job opportunities by firms ($253,029/wk) ($13,157,508/yr). It also caused 16,630 people to become unemployed by going into the workforce and being unable to find work 1,975,000 workers were employed at $4.75/hr. When the minimum wage was raised to $5.15 that number dropped to 1,926,341 meaning 48,659 people were put out of the workforce (approximately 2.5%). The remaining 1,926,341 saw their income rise a total of $20,033,942/wk ($1,041,764,984/yr—a little over $10/wk per worker). This amount was transferred from firms (consumers) and so had no effect on society as a whole. If we define minimum wage workers inclusive of the additional 16,630 workers who entered the workforce when the wage was raised and were unable to find work, then the total potential work force is 1,991,630 and the total of those unemployed is 65,289 which is approximately 3.3% of the minimum wage workforce. If we multiply this number by 26 to get labor hours, we get 1,697,514 Labor Hours/wk (88,270,728 LH/yr). If we multiply that by $5.15, we get $8,742,197/wk ($454,594,249/yr) income unearned by unemployed minimum wage workers. Compare this to the additional $20,033,942/wk ($1,041,764,984/yr) that the employed workers received, and we see that minimum wage workers as a whole were better off by $11,284,518/wk ($586,794,936/yr) as a result of the rise in the minimum wage. Noting that the supply and demand elasticities for labor were small, we can conclude that the strong economy of the mid 1990s offered opportunities such that the demand of firms for labor would not change much with a raise in the minimum wage and labor's desire to work for that wage would not rise that much either.

But you see that we calculated by using the supply and demand curve and then finding the area under the curves. So we successfully applied concept and fact to a math process. Again, this is both a fun yet tricky thing about economics.

Money and the Federal Reserve

Another thing I wanted to talk about here was money and the federal reserve. They are related inversely. The more money you have in a system, the less it's worth. The Federal Reserve controls the amount of money in our economy. They do this by either controlling the amount of money in the system, the actual dollars that are printed and lent to the banks for a very low interest rate (nearly free), or by adjusting the borrowing rate, the prime as they call it. The prime rate is the starting point that banks and other institutions use to set interest rates for you or I to borrow money. If the Fed feels there's too much money in the economy they don't take it out, but raise the borrowing rate such that people stop getting as many loans to buy big things like houses and start businesses. When the interest rate is higher, money flows less and so it tends to increase in its value. It's harder to get so it's worth more.

What the Fed will do if they want to infuse money into the economy is give banks cheap money and tempt them to loan it out. Each loan starts a kind of chain reaction of other loans. Ultimately, this leads to economic activity that creates more value for the initial investment the Fed makes. Basically it's like planting a seed and watching it grow into a plant. The plant that grows has its own agenda and takes on an identity far more brilliant than the seed. And it draws activity to it. Ideally the Fed wants to ignite activity.

To a point that is. Too much activity can spin an economy out of control and create a bubble. We experienced one of those in the late 90s and early 2000s in

the tech. market. A lot of money flowed into technology related stocks, so much that when the confidence in those stocks finally was shaken, the stock market fell like a house of cards. We saw a similar bubble, a worse one really, with the great collapse of 2008. The difference there though was money was fraudulently packaged in such a way as to make it seem more attractive than it actually was. The Fed however didn't see it happening. Even the Federal Reserve cannot do a lot to stop the economy from going from boom to bust since the processes are hard to control.

Right now we are in a circumstance where the Fed is keeping its interest rates very low, i.e., near zero. What this means is banks can get money from the Fed very cheaply, almost for free, to lend out. The problem right now is that many businesses and people don't want to borrow the money to spend on major purchases like hiring more workers because they're afraid that things will go south. It's a vicious circle because with high unemployment businesses fear their products and services won't sell, yet they have to give people jobs in order for them to be able to buy their goods and services. It's a matter of who has the courage to take the first step.

I've really only scratched the surface of economics. It is truly a fascinating subject because it is probably the oldest of the subjects we're treating on. There are those who argue all of history is based on economics. Karl Marx believed the movement of society was based on the economic needs of the times. We were a feudal society because that made the most sense for an agrarian culture. He then thought, as we embraced industry, we moved into a bourgeoise/worker relationship, i.e., the owner of the factory and the workers in it. In either case, the social structure followed the most efficient means to supply society's economic needs for a better life.

Economists are still doing that. Not all of them think the same. Many believe in free markets. Others not so much. Some believe in collective action while others believe in the selfish interest of the individual. There are a lot of opinions because opinions have been being given for an even a longer time than economics has been around.

BUSINESS SCHOOL IN A BOX

LEADERSHIP
FINANCE
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MARKETING
ECONOMICS
VALUES

VALUES

Truly, it's odd to have a bunch of people working together on anything. We are social animals of course, but trying to get us all to work together towards a common goal or set of goals is pretty weird. Also throw in the fact that the organization you might work for is paying you a very small percentage of what they are earning from your work. You are asked to put in a lot for very little (comparatively). There's an inherent disconnect in any kind of situation like this, one that we could actually connect back to the great Sigmund Freud. In his work "Civilization and Its Discontents" he wrote about how we, as individuals, generally give over a part of ourselves to the world we live in, whether it be society, family or work, or just rationality in general. We do this not so much because we want to, but because we make a rational decision that doing so is in our best interests, even though we don't particularly like it.

That being the case, our relationship with what we do is by its nature uncomfortable. And this sort of discomfort can lead to problems. This applies both to the least paid workers and the highest paid. Even the owners. Think about what happened at Adelphia, the cable company. The Rigas family, the majority owners and founders, stole $100 million for themselves from the company. They also hid over $2 billion in debt. There are numerous cases of company owners and officers cheating shareholders and the government. But of course the same is true of typical workers. Not the same type of behavior is seen there, but behavior that is unethical and often illegal nonetheless happens. Why does this happen is the question we want to ask?

The point of business ethics is two-fold: to prevent bad behavior on every level and to make those working for the company want to give their best to it. The ultimate goal of the well run, ethical company is to create an environment where

people really wish to work together and give the extra bit of effort that makes what you do together the best it can be.

I was in theater when I was younger with a group that did plays at least once a month. It was run completely by kids of various ages from 5 to 22. This was my first experience with an organization that worked the way a professional environment should. Myself and the other kids, though unpaid, strove to not only make our company successful but profitable because the money we made would facilitate doing the next show we wanted. We did some shows we knew would lose money, but we wanted to do anyway, and we did others that we knew were money makers, not only because they were popular but also because they had large casts of kids who would inevitably have hordes of relatives who would pay to see them. Guaranteed success!

But the point is we acted like professionals. We showed up for rehearsal and would not miss it without being really sick. It wasn't just a dictate down from above. You felt guilty if you were not performing at your best level both on the stage and off. No one ever had to say a word. It was simply in the culture. That's an example of a great business ethic.

How did that happen? And how can it be made to happen in a work environment you or I might be involved in now? That's a good question and one that we can begin talking about. First off, let's be straightforward here, the main reason for business ethics is so commerce can happen more easily. Ultimately the reason why we learn good behavior is that it just makes the things you have to do to survive that much easier. So business ethics are really about business, about allowing the trains to run on time more easily and not letting that human trait of feeling slighted, cheated, abused or wronged get in the way of doing a deal.

Now let's take this in another direction. Good behavior in business is also about elevating efficiency and ability, i.e., making people better at what they do. This can be complicated depending on the situation, but in general smart businesses manage to put across a good work ethic along with a strong philosophical and strategic set of guidelines. See, you work pretty much on your own in a big company. You may report to someone, but they aren't there every step of the way. Accordingly you have to sometimes think for yourself. Maybe a lot of the time. How then do you think in such a way as to do the best for your company?

Now, no company can tell you how to think and a good company would most certainly want your strong and independent thought, but a good company would also recognize that occasionally you might need help in making decisions, particularly those that aren't easy, where the options are close to one another. Here there is something called a strategic guideline that can help. Many of the best companies have them.

Strategic guidelines are usually a set of short statements, like mission statements, but not about what the goals of the company are in any lofty way. A strategic guideline is there to help you make a difficult decision, to help guide you to an answer which, while not immediately obvious as being the best for the company, yet maintains an overall philosophy the company wishes to follow. For example, consider what Federal Express does. In their strategic guidelines is a dictate that they should always tend towards new technology. What that can mean is that when you are a manager of a FEDEX office and you have to make a purchase of new software, you may be faced with a choice of buying the newest product out there or another that is serviceable but cheaper. FEDEX's guidelines would push you towards the newer technology.

That may seem like a rather small thing, but consider how such a guideline can snowball. You get the newest software, you have to get the newest other software to go with it, or newer hardware eventually. You discover innovative new things the software does. That gives you idea. See, FEDEX is about innovation. That's what got them started. So they feel it is in their culture to continually innovate and what better way to do that then to be exposed to everyone else's innovation?

Here's another example: UPS. A very similar company to FEDEX, UPS though focuses itself on operations. Operations are the business of making all the parts of a company work their best. One of UPS' guidelines is asking its drivers to always look for the shortest route to any destination. Now think about that. That's not easy. It's not just a matter of GPSing what the shortest mileage is between places, it's also about understanding road conditions, what the route is like in bad weather, what traffic is at what hour of the day, and how often there are accidents or other things that slow down traffic. Drivers are given a vast amount of leeway and independence to choose the paths they take. How does this match up with the culture of UPS? UPS is a longstanding company. It's made its reputation not by innovating but by service and price. FEDEX is rather expensive; UPS is usually much less so because they don't guarantee overnight. But they do guarantee something pretty close and also a variety of delivery times at less expensive prices. Therefore UPS knows that price point is going to be important to its clients. Still they want to impress you with their consistency. Notice how all the trucks are brown as are the company uniforms? Bland, unimportant, unnoticed. Exactly. They just get it there. It's always the same, always trustworthy and so unnoticeable you don't even think about why you use UPS. You just use it.

Ultimately of course no ethical or strategic guideline will stop people from behaving unethically. It’s really hard to be ethical all the time. Think of your own life. You tell white lies. You maybe don’t pay someone back as soon as you ought and you certainly don’t take all the time for homework you planned to every day. It just is in the nature of things to have difficult relationships with ethics or what you feel is right. The businesses that do it best are those that manage to tie the self-interest of their employees to good behavior. And that doesn’t mean just giving them incentives. It means making work exciting enough for them to feel that they are part of something that is really special. You want them to be ethical not just because they’d get in trouble for not being so, or even because to be so would be also in the best interest of their personal success. You want their job to feel like an extension of their own identity and the company to be that as well. You want their job to be something that completes them as human beings. This is self-interest on a higher plane.

This is not easy though. Business is not easy. Business is competitive and nerve-wracking. You can lose your shirt. You can also be very successful and have a lot of fun. Not to sound hackneyed, but it really is just like life. It is life really. Business sees things with an eye that's neither cynical nor hopeful. It's not even a realistic eye. It's rather a curious one. Beyond everything else, business aligns with that most human trait of curiosity. Business can and does touch literally everything, and so you get to see and deal with a whole host of things you may never have considered otherwise. There's something great about that.

We always say to ourselves we want to meet new people, do new things and understand how the other half lives. Business is the way that is done. You really see people for who they are. Yourself, too. You may or may not like what you see, but you'll learn from what you do, and learn not to judge yourself or others

too harshly because everyone out there is making the same mistakes you are. Even really successful people mess up. Sometimes they steal and lie and commit really horrible acts. Sometimes they do great and noble things.

It's just business. Business doesn't care about you. It doesn't not care about you either. It's just a tool or set of tools that help you do things in life. You can give it values and you should, but you choose to do that. Yes, there are laws which govern how you can behave, but many smart people can and do skirt laws every day, sometimes by following the law.

Remember what we said at the beginning. Business should be about learning to be a compassionate actor in the world. That's true not because that's better for you, your life, your soul or even your happiness, but because it's best for the world at large. Business can make everyone's lives better. Ultimately, compassion is efficient. We all suffer. We all struggle. We all need help. To be compassionate is to grow compassion in the world and give business and life a better chance to flourish.

BUSINESS SCHOOL IN A BOX

LEADERSHIP
FINANCE
ACCOUNTING
STRATEGY
MARKETING
ECONOMICS
VALUES