

## PART II

### THE BUSINESS ENTERPRISE

#### CHAPTER 3

##### The Business Enterprise

The business enterprise can be defined as a collection of productive resources with organizational structure and a specific social institution. The productive resources included both physical resources--plant, equipment, stocks of various material inputs and outputs and ownership of 'land'--and human resources--workers and management. These resources determine in part the range of activities which can be undertaken by the enterprise - ie production, purchasing, marketing and financing are activities which the enterprise can undertake if it has the proper resources to undertake and co-ordinate them. The organizational structure, about which more will be said below, refers to the way decisions are made and carried out regarding the enterprise's economic activity. The individuals who make and carry out the decisions are known collectively as the management and they hold the collective responsibility for co-ordination of the enterprise's activities and for making strategic decisions with regard to both investment and competitive strategies. As a social institution, the business enterprise is a specific capitalist institution which provides the mechanism for capitalists to obtain wealth and power and the reproduction of the capitalist class in a general sense. As such then, it embodies the existing social relationships in society, such as workers vs. capitalists and working classes vs. capitalist classes.

Given the business enterprise and our assumption that it is

the immediate private economic institution on which the continuation of capitalism rests, it is important to delineate some of its most important attributes: type of enterprise, ownership and control, motivation, managerial and administrative structure, long range planning, and accounting and other informational flows.

#### Type of Enterprise

The actual business of production takes place in a number of different type of enterprises, from small one-person stores and workshops to countrywide chains and giant manufacturing enterprises. In the United Kingdom around 70 per cent these business enterprises are owned in one form or another by private people or groups of people. These enterprises together form what is known as the private sector of the economy. Private business enterprises can be legally organized on a non-corporate or corporate basis.

Two types of non-corporate enterprises are normally recognised: sole proprietorships and partnerships. In the case of sole proprietorships, the business enterprise is co-existent with the individual entrepreneur; that is, the enterprise is created by the individual from his/her own wealth holdings and personal borrowing who has sole control of its operations and ceases to exist when the entrepreneur dies, becomes incapacitated, or decides to cease operation. The owner is subject to unlimited personal liability for all the obligations of the business and he/she cannot limit his risk or investment in the business to a pre-determined portion of his assets. The legal responsibilities of the owner include registering for value

added tax if total sales are above a limit set by the law; pay income tax and National Insurance contributions on earnings; and incur special legal obligations for care and accuracy in describing and selling stock. A partnership is an association of two or more persons to carry on as co-owners of an enterprise for profit. It can be formed by either an agreement or conduct of the parties, expressed or implied. It dissolves when any one of the partners dies or leaves. Each partner is subject to unlimited liability, including liabilities flowing from wrongful acts of another partner, as well as the legal responsibilities noted above for sole proprietorship.

A corporate business enterprise has a legal identity quite separate from those who own it. This means, for example, that it can own property in its own right, employ people, including members, in its own right and sue and be sued for breach of contract. To become a corporate enterprise, the applicants must submit an application for registration and support documents to the Registrar of Companies. The supporting documents include memorandum of association which lists the name and location of the enterprise, nominal capital, whether limited or unlimited liability, and objects of the enterprise; articles of association which states the way the enterprise is to be run; a statutory declaration that the requirements of the relevant Companies Act have been met; and a statement of directors and secretary and address of registered office. Upon receiving the application and documents, the Registrar of Companies will issue a certificate of incorporation. Once received the registered corporation must also meet a number of additional legal obligations, such as

submitting annual accounts to the Registrar and anybody can see a copy of these accounts on payment of a small fee. A corporate enterprise may have limited or unlimited status--the former means that the shareholders have limited liability whereas the latter this protection is not availability. Limited corporate enterprises are the most numerous and they can be divided into private and public enterprises. The former constitute those enterprises whose shares are held by individuals and are not sold to the general public; whereas the shares of the latter are sold to the public and they must have issued at least £12,500 of the original share capital.

The U.K. economy is inhabited by business enterprises which lie outside the context of the private enterprises mentioned above. These enterprises do not exist to make profits for their owners; indeed, they do not have owners in the normal sense at. They are societies or groups of people who originally came together to provide for their members benefits that, at the time, were not available anywhere else. These include co-operative enterprises, building societies, government (or public) corporations, and government services.

#### Ownership and Control

Control of an enterprise means the power to make its key decisions, which includes choices of products, major markets, volume and direction of investment, larger commercial and political strategies, and selection of top personnel. In an sole proprietorship or partnership, it is easy to see that the owners have control. However, in the case of the corporation, the relationship between ownership and control is not as easy to

ascertain. Aside from the case where an individual owns all the corporation's shares, the situation can arise where some, most or all of the owners (shareholders) have no control. In one case, management control, the power over key decisions is held by a group of individuals inside the corporation and is usually headed by the chief executive officer. Its power stems in large part from its authority and dominance over day-to-day operations, the disposition of company resources, and the planning and long-term decisions of the company. The top officers and their employee subordinates devote full time to doing the business of the corporation, assessing its problems and prospects, and making and implementing plans for its improvement. By virtue of this concentrated effort and presence, they have special command over the technical details essential to an intelligent consideration of company problems. They also must of necessity make a great many immediate decisions that require experience, knowledge, and on-the-spot presence. Most of the specific decisions involved in day-to-day operations are made by middle managers, but those at the top call the tune, set the parameters within which choices are made, and make some of the important specific decisions (including the compensation, promotion and ouster of those below them in the managerial hierarchy). These are built-in advantages of top management that give it a structure of dependencies both within the organization and outside (customers and suppliers), and thus give it power. This power extends to the board selection process and board decision-making. Domination of the board and proxy machinery of the corporation is the link between the de facto power of the managerial leadership and the legal,

but nominal, power of the diffused ownership.

Other cases include majority ownership control where the power over key decisions is held by an individual, family, or small group which owns in excess of 50% of the voting shares. It is, of course, assumed that the owners take an active part in running the enterprise. There is also minority ownership control where the power over key decisions is held by a group which owns 5% or more of the voting stock. Their control rests on the strategic positions in management held by members of the group. And finally there is financial control where the power over key decisions is held by individuals, groups, or organizations whose primary interest is the performance of external financial functions - either raising and supplying funds, buying and selling securities, or both. However, in most cases, financial control is simply being able to veto a specific activity management wants to undertake rather than being in the control of the day-to-day and long term activities of the corporation. But in the past, financial control was real and was based on sizable ownership holdings or on strategic position obtained through promotion or re-organization (often combined with ownership).

#### Motivation

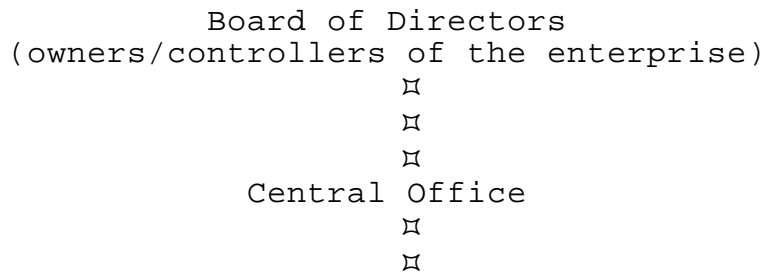
The motivation of the business leaders of the enterprise is hierarchical arranged. The most basic motivation is survival, that is the reproduction and continuation of the business enterprise. On top of survival, there exists various motivations based on particular objectives. In particular, the enterprise has a profit motive inasmuch as that ensures its survival and is the basis for other goals/motivation. Moreover, these subsequent

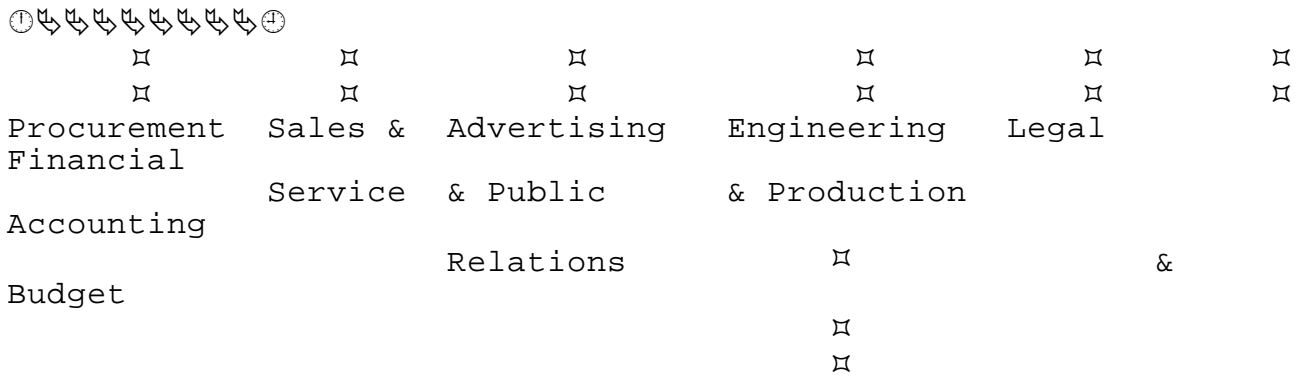
goals/motivations may have different temporal dimensions, maybe tied directly or indirectly to enterprise survival, and may alter the enterprise's environment so as to force it to adopt a new set of goals/motivations.

Managerial and Administrative Structure

In small business enterprises which produce a single 'product' and sell it a single location, the owners generally work along side their employees and personally makes all the decisions. On the other hand, the large public or private corporations rely on bureaucratic structures to both manage and direct its different activities. Although the particular bureaucratic structure in place in a business enterprise will vary, they can generally be classified as a functional managerial structure with its associated centralized administrative structure, and a divisional managerial structure with its associated decentralized administrative structure.

A functional managerial structure is simply a structure by which an enterprise's activities are grouped and managed according to function. That is, each activity the enterprise engages in is placed in a particular category, such as sales, manufacturing, purchasing, etc. according to its function. Thus a functional managerial structure would look like the following:





Under a centralized administrative structure there is a central office which coordinates the various departments and directs them towards a common goal. It consists of the chief executive officer, his assistants, and the heads of the department. In turn, the department heads manage the departments as if they are a single-activity business enterprise striving for cost efficiency and economics of scale. Thus the administration of the enterprise is centered in the central office with control being dispersed along functional lines.

The virtue of this structure is that it lets the middle management specialists run the day-to-day activities of the enterprise, thus letting top management coordinate the activities of the various departments and become involved in long term planning. Yet it has a basic weakness - very few men or women are entrusted with a great number of complex decisions. Moreover, the heads of the departments are often too busy with the running of their department to devote much time to the affairs of the enterprise as a whole. Their training proved to be a still more serious defect. Because the members of the

central office spent most of their business careers within a single functional activity, they had little experience or interest in understanding the needs and problems of other departments or of the enterprise as a whole. As long as the enterprise stays in an industry (or industry group) whose markets, sources of raw materials, and production processes remained relatively unchanged, few entrepreneurial decisions need to be reached, hence such a weakness is not critical. But when the enterprise's technology, markets, and sources of supply become highly diverse as a result of the diversification and growth (especially into different industry groups), the defects of the structure become obvious.

If a business enterprise adopts a strategy of diversifying its activities, it will eventually adopt a divisional managerial structure with a decentralized administrative structure. The problems of obtaining materials and supplies, of manufacturing, and of marketing a number of product lines for different types of customers makes the tasks of the department heads difficult to administer systematically and rationally. The coordination of product flow through the several departments is even more formidable. Appraisal comes to involve not only a constant intelligence analysis of the operating performance in the different economic functions, including engineering and research as well as production, distribution, transportation, the procurement of supplies, and finance, but the making of these appraisals in several very different markets. Long term strategic planning not only called for decisions and actions concerning the future use of existing facilities, personnel and





various factors push them towards establishing a specific group of employees who engage in long range planning. The internal conditions to an enterprise necessitating the development of long range planning include:

- (1) trend to industrial decentralization. A formal structure was required to coordinate and relate the decentralization of corporate product efforts among many relatively autonomous and functionally integrated divisions. Underlying this change was the increased scope and magnitude of enterprise operations and the greater complexity and diversity of the product mix. The existence of a decentralization policy, coupled with growth and diversification, stimulated the need for the establishment and centralization of long range planning functions. Approaching stagnation in profit divisions and the change from a homogeneous one-industry enterprise to a diversified decentralized administrative structure enterprise further motivated the desire to develop a far-future planning effort.
- (2) Company growth and complexity. In the case of a highly divisionalized enterprise, there is a tendency for each division to optimize its own operations and plans as it understands them without full knowledge of the corporate activity directed toward the same goal. When the enterprise is small this total corp. coordination is relatively simple and effective; as the enterprise grows, it is more and more time-consuming for the top management to perform this function unaided; a gradual evaluation to more formalized

handling of this responsibility is to be expected. Thus, the long range planning effort effected by a staff agency, evolves,

- (3) Internal dissatisfaction with decentralized unit and enterprise profit margins. Over-concentration of sales in one general product line or a need for growth and diversification at an accelerated rate to overcome the depressing effect of the declining sales of one product motivated the need for long range planning.
- (4) Growing obsolescence of equipment, ageing of key executive personnel and ultimate retirement of founders; prudent allocation of resources for rationally selected enterprise sponsored research and development programs.

The business enterprise also faces external factors which pushes them towards long range planning.

- (1) Competitive Elements: Competitive elements motivating the need for long-range planning include such factors as the expansion of markets and increasing competition particularly since World War II. Increasing research and development costs incurred in order to keep pace with the dynamic move of technological change, coupled with the rise of research and innovation in all fields of functional work required a revision of existing planning policies and procedures of the competitive business enterprise. In order to remain competitive, the enterprise was required to increase its research commitments in "frontier products"; financial outlays involved for the research and development programs became so huge that long-range planning became necessary so

the expenditures involved were compatible to the probabilities of the pay-off. The decline in funding for traditional products, coupled with an increasing product obsolescence and an increased demand fostered by an expansion of markets, made a longer view mandatory for business units. As technology increased and products became more complex, the period required for product development lead time increased; product substitutes were offered with increasing frequency both from domestic and foreign sources.

Higher capital costs were incurred and profit margins were reduced accordingly. Collateral with these changes the business unit increased in size and complexity; the number and rapidity of major changes affecting business increased.

Business became more competitive through (1) diversification by other enterprises; (2) saturation of markets and excess capacity; (3) competitors' innovations, improvements, and new strategies; (4) foreign production; (5) increasing size and term of capital commitments.

Another factor explaining the attention to long-range planning is that financial analysts in search of growth companies have reacted favourably to situations where management has attempted to forecast the specific shape and scope of potential growth and then has taken positive action in anticipation of future demands. The fact that some of the leading corporations in the United Kingdom developed a philosophy of long-range planning no doubt forced competitors to do likewise in order to compete adequately.

(2) Production Techniques: increasing mechanization and

automation, stimulated by technological influences in manufacturing methods and processes, required long range planning by management groups before committing the large capital outlay required to support these programs.

- (3) Trade union influence: trade union contracts combined with growing fringe benefits, provisions for guaranteed annual wages, contributions for supplemental unemployment benefits have necessitated long range planning for labour costs.

As a result of the need for planning for dealing with the unknown, enterprises have generally constructed a best long range plan and alternative long range plan, growth and contractions long range plans, and engage in continuous long range planning.

The enterprise undertakes two kinds of long range planning - the first kind consists of activities which operate in the present but also has a significant impact on the enterprise's future. The most significant of these is price setting, especially with respect to the determination of the margin for profit. The procedures used to set the price, especially the cost aspect of the price, are originally determined by the central office and then are "mechanically" used by the lower level managers when setting and changing the price. Likewise, the margin for profit is determined by the central office and then routinely used by the lower management in price setting. It should also be noted that lower management handles price changes even if it involves changes in the profit mark up if it falls within an agreed upon competitive conditions, such as meeting the prices of competitors. The second kind of long range planning deals with activities that concern the enterprise's future.

Consequently, it is a function of the central office, although the actual planning is generally undertaken by a sub-committee which included individuals from the areas of marketing, engineering, economics, management, statistics, finance and production. The purpose of the subcommittee is to determine which line of activity the firm should allocate its profits in order to maintain itself as a growing concern. Some of the activities include investment in existing commodity lines, creation of new commodity lines, diversification and forward and backward integration via enterprise acquisition and merger. Also concerned with major changes of profit margin on existing and new products when it has significant impact on the enterprise.

#### Accounting and Information Flows

The business enterprise can be viewed as consisting routine behaviours which provide a way of coping in a complex and uncertain world, and which enable individual managers to make sense of their own actions and the actions of others. However, these organizational routines are the skilled accomplishment of the individual managers. As such, the routines are both the medium and outcome of individual behaviour. To continue to function on a day-to-day basis, managers need to know what routines to perform and when, and there must be a suspension of intra-enterprise conflict. The routines give form and social coherence to enterprise activities and provides the mechanism which all enterprise traits to be transmitted through time. Through such a process routines and institutions evolve in the specific circumstances of the enterprise and its environment. However, although enterprises are undoubtedly profit-seeking

organizations there is no strong reason to believe that the routines will inevitably evolve to give optimal choices. Finally, routines need not be highly formalized organizational procedures; they can be managerial heuristics and informal processes which are habitually used within the enterprise.

Accounting rules and procedures provide an important way of representing economic facts to the management and the owners of the enterprise. Enterprise performance is reported and described, both internally and externally, according to accounting rules, conventions, and language. Further accounting practices provide an interpretive scheme for making sense of enterprise activities. But as well as providing the means of representing performance, accounting rules and procedures also define the rights of individual groups (shareholders, lenders, managers, and workers) and they provide a basis for prescribing actions such as how to carry out sales and bank reconciliations, carry forward a knowledge of the procedures for budgeting and capital expenditure and costing and pricing, and frame the enterprise's policies regarding research and development and transfer-pricing. Consequently, accounting provides the institutional basis for decision-making and structures the formation of expectations and beliefs. That is, the extent to which accounting practices give social coherence and meaning to organizational behaviour within the enterprise allows managers and other groups within the enterprise to give meaning to their day-to-day activities.

#### Terms

Sole Proprietorships

Partnership  
Corporate Enterprise  
Ownership  
Control  
Management Control  
Majority Ownership Control  
Minority Ownership Control  
Financial Control  
Functional Managerial Structure  
Centralized Administrative Structure  
Central Office  
Divisional Managerial Structure  
Decentralized Administrative Structure  
Long Range Planning

### Exercises and Questions

1. Discuss the nature of the business enterprise, focusing on its boundaries, its organizational structure, and its motivation.
2. What are the essential features of the large business enterprise.
3. What implication does the separation of ownership from control have for the operation of the business enterprise?
4. Why do managerial resources drive the business enterprise to grow and change? Are there any limits or constraints on managerial resources?
5. In what ways can the business enterprise be seen as a capitalist institution?
6. Describe the emergence of the modern corporation in the United Kingdom its impact on the economy.
7. In what ways can the business enterprise be seen as a capitalist institution?
8.
  - a. Describe the ways business enterprises are legally organized and owned.
  - b. Explain why individuals who legally own the business enterprises do not necessarily control the business enterprise.
  - c. Describe the different kinds of control.
9.
  - a. Describe a functional managerial structure and a centralized administrative structure.
  - b. Describe a divisional managerial structure and a decentralized administrative structure.

10. What is long range planning? What are the two general types of long range planning?
11. Price setting is one aspect of long range planning. Discuss.

#### Readings

1. A. S. Eichner, "The Megacorp as a Social Innovation," in Towards a New Economics, pp. 10 - 27.
2. A. D. Chandler, The Essential Alfred Chandler, chs. 2, 3, 8, 9, 14, 15, and 16.
3. A. D. Chandler, Scale and Scope.
4. D. F. Channon, The Strategy and Structure of British Enterprise.
5. R. W. Scapens, "Never Mind the Gap: Towards an Institutional Perspective on Management Accounting Practice." Management Accounting Research, Vol. 5: 3-4, pp. 301 - 321.