**COURSE GUIDE**

# ENT 410
# CORPORATE DEVELOPMENT: MERGERS AND ACQUISITIONS


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**CONTENTS**

Introduction

Course Contents

Course Aims

Course Objectives

Working through This Course

Course Materials

Study Units

Textbooks and References

Assignment File

Assessment

Tutor-Marked Assignment

Final Examination and Grading

How to get the Best out of this Course

Facilitators/Tutors and Tutorials

Useful Advice

Summary

## INTRODUCTION

ENT410: Corporate Development is a two credit course for students offering B. Sc. Entrepreneurship and Business Management in the Faculty of Management Sciences. The course consists of eighteen (15) units, that is, three (3) modules of five (5) units for each module. The material has been developed to suit undergraduate students in Entrepreneurship and Business Management at the National Open University of Nigeria (NOUN).

The course guide tells you briefly what the course is about, what course materials you will be using and how you can work your way through these materials. It suggests some general guidelines for the amount of time you are likely to spend on each unit of the course in order to complete it successfully. It also gives you some guidance on your tutor-marked assignments. Detailed information on tutor-marked assignment is found in the separate assignment file which will be available in due course.

## COURSE AIMS

The aims of the course will be achieved by:

(i) Discussing corporate governance on Consolidation policy
(ii) Discussing mergers and acquisitions in Nigeria
(iii) Explaining merger procedures for Small, Large and Intermediate enterprises
(iv) Explaining documentation for required business combination transactions
(v) Understanding what mergers and acquisitions are all about
(vi) Discussing the relationship between various forms of corporate strategies
(vii) Identify the various issues and challenges in mergers and acquisitions
(viii) Discussing disclosure of negotiations in mergers and acquisitions

## COURSE OBJECTIVES

By the end of this course, you should be able to:
(i) Understand the key company initiatives for corporate development
(ii) Identify various techniques for corporate development
(iii) Explain what a corporation is and the roles it performs;
(iv) Understand what a merger is and reasons for mergers
(v) Identify various types of mergers and the procedures for mergers
(vi) Understand the legal framework for Banks consolidation in Nigeria.

## WORKING THROUGH THIS COURSE

To complete this course, you are required to read all study units, attempt the entire tutor marked assignments and study the principles and practice of lending and credit administration in this material provided by the National Open University of Nigeria (NOUN). You will also need to undertake practical exercises for which you need access to a personal computer. Each unit contains self-assessment exercises, and at certain points during the course, you will be expected to submit assignments. At the end of the course is a final examination. The course should take you about a total of 17 weeks to complete. Below are the components of the course, what you have to do, and how you should allocate your time to each unit in order to complete the course successfully on time.

COURSE MATERIALS

Major components of the course are:

(i) Course Guide
(ii) Study Units
(iii) Textbooks
(iv) Assignment file

STUDY UNITS

The study units in this course are as follows:

MODULE 1

Unit 1: Corporate Development
Unit 2: Mergers and acquisitions
Unit 3: Mergers and Acquisitions: Opportunities and avoiding the pitfalls
Unit 4: Mergers and Acquisitions: Challenges and Regulatory Authorities
Unit 5: Concept of Corporate strategy

MODULE 2

UNIT 6: Forms of Strategy
UNIT 7: Banking Sector Consolidation
UNIT 8: Consolidation in the oil and Gas Industry: Mergers and Acquisitions
UNIT 9: Incentives on Consolidation in the Nigerian Banking Industry
UNIT10: Products

MODULE 3

UNIT 11: Product-Mix Strategies
UNIT 12: New Product Development
UNIT 13: Product Development Theories

UNIT 14: Quality
UNIT 15: Total Quality Management

## ASSIGNMENT FILE

There are two aspects to the assessment of the course: first is the tutor-marked assignment; and secondly, the examination. Within each unit are self-assessment exercises, which are aimed at helping you to check your assimilation as you proceed. Try to attempt each of the exercises before finding out the expected answers from lecture. In tackling the assignments, you are advised to be sincere in attempting the exercises; you are expected to apply information, knowledge and techniques gathered during the course.

## TUTOR-MARKED ASSIGNMENT (TMAS)

This is your continuous assessment and accounts for 30% of your total score. You are expected to answer at least four TMA's, three of which must be answered and submitted. However, it is desirable in all degree level education to demonstrate that you have read and researched more widely than the required minimum. Using other references will give you a broader viewpoint and may provide a deeper understanding of the subject.

## FINAL EXAMINATION AND GRADING

With this examination written successfully, you have completed your course in Basic research and one believes you would apply your knowledge (new or up-graded) in your project. The 'end of course examinations' would earn you 70% which would be added to your TMA score (30%). The time for this examination would be communicated to you.

## HOW TO GET THE BEST FROM THIS COURSE

In distance learning, the study units are specially developed and designed to replace the conventional lectures. Hence, you can work through these materials at your own pace, and at a time and place that suits you best. Visualize it as reading the lecture.
This is one of the great advantages of distance learning. You can read and work through specially designed study materials at your own pace, and at a time and place that suits you best. Think of it as reading the lecture that a lecturer might set you some readings to do, the study unit will tell you when to read other materials. Just as a lecturer might give you an in-class exercise, your study units provide exercises for you to do at appropriate points.

Each of the study units follows a common format. The first item is an introduction to the subject matter of the unit, and how a particular unit is integrated with the other units and the course as a whole.

Next is a set of learning objectives. These objectives allow you to know what you should be able to do by the time you have completed the unit. You should use these objectives to guide your study. When you have finished the unit, you must go back and check whether you have achieved the objectives. If you make a habit of doing this, you will significantly improve your chances of passing the course.
The main body of the unit guides you through the required reading from other sources. This will usually be either from a *Reading Section* of some other sources.

Self-tests are interspersed throughout the end of units. Working through these tests will help you to achieve the objectives of the unit and prepare you for the assignments and the examination. You should do each self-test as you come to it in the study unit. There will also be numerous examples given in the study units, work through these when you come to them too.

The following is a practical strategy for working through the course. If you run into any trouble, telephone your tutor. Remember that your tutor's job is to help you. When you need help, don't hesitate to call and ask your tutor to provide it.

(1) Read this course guide thoroughly.
(2) Organize a study schedule. Refer to the course overview for more details. Note the time you are expected to spend on each unit and how the assignments relate to the units. Important information e.g. details of your tutorials, and the date of the first day of the semester will be made available. You need to gather all this information in one place, such as your diary or a wall calendar. Whatever method you choose to use, you should decide on and write in your own dates for working on each unit.
(3) Once you have created your own study schedule, do everything you can to stick to it. The major reason that students fail is that they get behind with their coursework. If you get into difficulties with your schedule, please let your tutor know before it is too late for help.
(4) Turn to unit 1 and read the introduction and the objectives for the unit.
(5) Assemble the study materials. Information about what you need for a unit is given in the 'Overview' at the beginning of each unit. You will always need both the study unit you are working on and one of your references, on your desk at the same time.
(6) Work through the unit. The content of the unit itself has been arranged to provide a sequence for you to follow. As you work through the units, you will be instructed to read sections from your set books or other articles. Use the unit to guide your reading.
(7) Review of the objectives for each study unit and confirm that you have achieved them. When you are confident that you have achieved a unit's objectives, you can then start on the next unit. Proceed unit by unit through the course and try to face your study so that you keep yourself on schedule.

(8) After completing the last unit, review the course and prepare yourself for the final examination. Check that you have achieved the unit objectives (listed at the beginning of each unit) and the course objectives (listed in the Course Guide).

**SUMMARY**

This course ENT410 is designed to give you some knowledge which would help you to understand corporate development as applied to corporate governance and consolidation in Nigeria. After going through this course successfully, you would be in a good position to pass your examination at the end of the semester and use the knowledge gained to apply in your daily entrepreneurial activities. You will also be able to contribute to the development of scholarly thoughts in entrepreneurship and business management as it affects corporate development and corporate governance.

We hope you enjoy your acquaintances with the National Open University of Nigeria (NOUN). We wish you success in this interesting course and hope you will use what you have learnt in this course to apply to knowledge.

## MAIN CONTENT

**CONTENTS** **PAGE**

**Module 1……………………………………………………………………………… 1**

UNIT 1: Corporate Development……………………………………………….. 3
UNIT 2: Mergers and acquisitions……………………………………………. 9
UNIT 3: Mergers and Acquisitions: Opportunities and avoiding the pitfalls…… 13
UNIT 4: Mergers and Acquisitions: Challenges and Regulatory Authorities…… 20
UNIT 5: Concept of Corporate strategy………………………………………. 29

**Module 2………………………………………………………………………………. 29**

UNIT 6: Forms of Strategy…………………………………………………… 25
UNIT 7: Banking Sector Consolidation………………………………………. 40
UNIT 8: Consolidation in the oil and Gas Industry: Mergers and Acquisitions… 44
UNIT 9: Incentives on Consolidation in the Nigerian Banking Industry………… 54
UNIT 10: Products…………………………………………………………... 59

**Module 3………………………………………………………………………………. 68**

UNIT 11: Product-Mix Strategies……………………………………………….. 68
UNIT 12: New Product Development…………………………………………... 78
UNIT 13: Product Development Theories……………………………………. 96
UNIT 14: Quality…………………………………………………………... 105
UNIT 15: Total Quality Management………………………………………… 112

## MODULE 1

Unit 1: Corporate Development
Unit 2: Mergers and acquisitions
Unit 3: Mergers and Acquisitions: Opportunities and avoiding the pitfalls
Unit 4: Mergers and Acquisitions: Challenges and Regulatory Authorities
Unit 5: Concept of Corporate strategy

## UNIT 1 CORPORATE DEVELOPMENT

**CONTENTS**

1.0 Introduction
2.0 Objectives
3.0 Main Content
3.1Corporation or Incorporation
3.2 Corporate developments
4.0 Conclusion
5.0 Summary
6.0 Tutor-Marked Assignment
7.0 References/Further Readings

### 1.0 INTRODUCTION

Meaning of a 'Corporation' today, organizations are conducting their businesses to suit current trend in technology and innovation. A corporation is a legal entity that is separate and distinct from its owners. Corporations enjoy most of the rights and responsibilities that an individual possesses; that is, a corporation has the right to enter into contracts, loan and borrow money, sue and be sued, hire employees, own assets and pay taxes.

The most important aspect of a corporation is limited liability. That is, shareholders have the right to participate in the profits, through dividends and/or the appreciation of stock, but are not held personally liable for the company's debts.

A corporation is a business or organization formed by a group of people, and it has rights and liabilities separate from those of the individuals involved. It may be a nonprofit organization engaged in activities for the public good; a municipal corporation, such as a city or town; or a private corporation (the subject of this article), which has been organized to make a profit.

## 2.0 OBJECTIVES

At the end of this unit, the student should be able to:

1. Demonstrate the understanding corporation
2. Be knowledgeable about forming a Corporation
3. Understand the key company initiatives for corporate development

## 3.0 MAIN CONTENT

### 3.1 Corporation or Incorporation

Browne'sCiv.Law,99;Civ.Code of Lo.art.418; defines a corporation as follows: "A corporation, or body politic, or body in corporate, is a collection of many individuals united in one body, under a special denomination, having perpetual succession under an artificial form, and vested by the policy of the law, with a capacity of acting in several respects as an individual, particularly of taking and granting property, contracting obligations, and of suing and being sued; of enjoying privileges and immunities in common, and of exercising a variety of political rights, more or less extensive, according to the design of its institution, or the powers conferred upon it, either at the time of its creation, or at any subsequent period of its existence."

In the eyes of the law, a corporation has many of the same rights and responsibilities as a person. It may buy, sell, and own property; enter into leases and contracts; and bring lawsuits. It pays taxes. It can be prosecuted and punished (often with fines) if it violates the law. The chief advantages are that it can exist indefinitely, beyond the lifetime of any one member or founder, and that it offers its owners the protection of limited personal liability.

#### 3.1.1 Limited Liability

If you own shares in a corporation that cannot pay its debts and is sued by its creditors, the assets of the company may be seized and sold. But although you can lose your investment, the creditors cannot attach your personal assets (such as cars, houses, or bank accounts) to satisfy their claims.

There are some important exceptions to this rule, however. If the business affairs of a corporation and its shareholders are so entangled that they are, in effect, one and the same, an opponent in a lawsuit may be able to convince a court to "pierce the corporate veil" and impose personal liability, or responsibility, on the active

shareholders. Personal liability may also be imposed if the corporation does not comply with required legal formalities or fails to keep proper records.

3.1.2 Forming a Corporation

If you want to form a corporation, you must obtain a state charter. Here are some things to do before you apply:

Choose the state in which you want to incorporate. This will usually be the state where your company has its headquarters or where it conducts most of its business. Some people prefer to incorporate in states that impose few regulations or no corporate income tax, such as Delaware, Nevada, and Wyoming.

Decide whom you want as officers. Although many states require at least two or three parties to form a corporation, they need not all be shareholders. You may want to ask friends or family members to serve as the initial officers. If you remain the sole shareholder, you alone will control the corporation's activities.

**SELF ASSESSMENT EXERCISE**

1. What are the procedures for forming a Corporation?

## 3.2 Corporate Development

This refers to the planning and execution of a wide range of strategies to meet specific organizational objectives. The kinds of activities falling under corporate development may include initiatives such as recruitment of a new management team, plans for phasing in or out of certain markets or products, considering a partner for a strategic alliance, establishing relationships with strategic business partners, identifying and acquiring companies, securing financing, divesting of assets or divisions, increasing intellectual property assets and so on. There is no formula for "corporate development" and the activities encompassed are often the role of the CEO or other executives or experienced business consultants.

### 3.2.1 Techniques for Corporate Development

**1. Process**

There is no one tried and true formula for the process of corporate development. The actual structure of the corporate strategy will depend greatly on the current circumstances of the company and the area where the development is desired. In most cases, the process will not be of short duration; corporate development is usually a process that takes place over an extended period of time and may be adjusted or refined as the project moves forward (is under development).

## 2. Reshaping Management

One of the manifestations of corporate development has to do with reshaping the management arm of the corporation. This may involve a process of phasing certain management positions out of the existing structure or creating new positions in an effort to strengthen the management team. As part of this type of approach, corporate development may also demand that one or more current managers are released from the company and replaced with people who possess skills required to move the company forward. When this is the case, the corporate development team will handle the functions of recruitment and evaluation of potential hires.

## 3. Growing the company

The process of corporate development can also be applied to the task of growing the company through mergers and acquisitions. In this scenario, the project development will involve identifying potential target companies for acquisitions or unions resulting in a new and more aggressive corporation. The team will consider all possible outcomes from any given potential merger or acquisition and attempt to project if the action is likely to result in positive growth or could possibly impair the company permanently.

Just as a management team may be revamped, corporate development may also be employed to change the current focus for clients. This may mean looking into the potential for breaking into new markets with existing products or developing complementary products that will allow this type of expansion. Corporate development strategy would monitor the trends associated with a corporation's products or services and helps the corporation establish strategies to find more customers. In addition, corporate development works to maximize the profits of a corporation by figuring out the appropriate pricing for a given good or service. A corporate development team also leads discussions with sales department heads regarding how to market corporate goods, organize marketing campaigns, analyze market research and incorporate any customer advice or complaints into marketing strategies in such cases; extensive industry specific business experience is often preferred which is why companies may hire an external firm to help them engage in such moves.

Depending on the status of the base market, corporate development may also look at shifting away from a shrinking consumer market while seeking market share in a different consumer market with newer products. For example, many typewriter manufacturers during the 1980s and 1990s slowly phased out their core business and began to focus more on computer parts and accessories as a way to continue operations.

## 4. Need for specialists

Particularly in larger companies, corporate development is provided as a charter for a particular executive or team. In these cases, the opportunities and initiatives are numerous enough to justify specialists, instead of being delegated to the office of the CEO and line of business executives. When focused on product or financial issues, corporate development executives often have MBA, CFA or CPA credentials. Often the internal corporate development executives come from a legal or investment banking background, due to the complex contractual and valuation issues associated with many transactions.

Corporate development involves the quantification and qualification of business and market risk using an analytical and evidence- based process built around detailed industry- specific factors and market measures. Each assessment measures and compares performance/ potential against detailed market, industrial and competitive datasets and focuses on

### 3.2.2 Key company initiatives are:

1. Corporate Diversification: A process that enables a client to evaluate the cost/ benefits of diversification into new product markets by profiling its competencies in current markets, benchmarking them against known success criteria/ good practice for the new markets, quantifying the corporate gap in terms of risks/ opportunities/ costs, translating the outcome of the research and analysis into a clearly defined action plan.

2. Corporate Growth: A process that measures the options for new business growth (in terms of products and markets) and the associated risks/ rewards of each option. Our analysis looks at current corporate performance, profiles it against the requirements for success in current and new markets, identifies the key risk areas and what is needed to address them. The final output is an action plan for achieving targeted company growth.

3. Globalisation: A process that identifies the opportunities and the required actions for a company to “go global” in its chosen markets. Our research process can quantify and qualify the new target markets, identify entry points into those markets, analyse current company performance and identify the changes necessary to achieve globalisation and devise the new business model/ strategy necessary to achieve and sustain global status.

4. Consolidation: A process that measures company performance in its current markets, compares this performance with competitors and with market requirements, identifies the markets where the company has the greatest competitive profile, devises the new business model/ strategy for consolidation

around the selected markets and identifies the actions necessary to reduce business risk and improve profitability through consolidation.

5. Corporate Re-Cycling: A process that enables the client to fully evaluate the business options for the re-cycling or re-purposing of a “problem site”. Our research includes measuring the capabilities of the site, identifying new applications (products and markets) for those capabilities and developing the business model/ strategy for the “new” business.

## 4.0 CONCLUSION

We noted from the unit that a corporation has many of the same rights and responsibilities as a person. It may buy, sell, and own property; enter into leases and contracts; and bring lawsuits. While corporate development involves the quantification and qualification of business and market risk using an analytical and evidence- based process built around detailed industry- specific factors and market measures. The various techniques of corporate development and the key company initiatives have been discussed, while the need for the existence of a company has also been explained

## 5.0 SUMMARY

In this unit we have discussed the meaning of a 'corporation', corporate development, techniques for corporate development and key company initiatives for corporate development. We also discussed the techniques for corporate development and key company intiatives for corporate development such as corporate diversification, corporate growth, globalization, consolidation and corporate re-cycling. We shall proceed to consider Mergers and Acquisitions in the next unit.

## 6.0 TUTOR-MARKED ASSIGNMENT

a) Give detail account of your expectations, if you want to form a corporation.

b) What do you understand by corporate development?

c) Explain the key company initiatives for corporate development.

## 7.0 REFERENCES/FURTHER READINGS

Bataille, G. (1985). “Nietzsche and the fascists.”In*Georges Bataille Visions of excess. Selected writings, 1927-1939* (translated by A. Stoekl). Minneapolis: University of Minnesota Press.

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## UNIT 2 MERGERS AND ACQUISITIONS

## CONTENTS

1.0 Introduction
2.0 Objectives
3.0 Main Content
3.1 Types of Mergers
3.2 Mergers and Acquisitions in the Globe
3.3 Mergers and Mergers in Nigeria – 29 Years After
3.4 The Legal Framework of Mergers and Acquisitions
4.0 Conclusion
5.0 Summary
6.0 Tutor-Marked Assignment
7.0 References/Further Readings

## 1.0 INTRODUCTION

In the world of business, mergers and acquisitions constitute a powerful growth tool used by companies to achieve long-term growth and increased revenue or profitability. It is a tool used for expanding the operations of a company with a view to achieving growth. Mergers and acquisitions are crucial to the growth and health of an economy being a highly attractive means for business owners and entrepreneurs to get value from the wealth they have contributed in creating. Mergers are vital tools used by companies for the purpose of expanding their business operations with objectives ranging from increasing their size, long term profitability or relevance within a particular market.

The term mergers and acquisitions and consolidation may often be confused, they look
similar and mostly used interchangeably. However, the three different meanings of Mergers may be of various types and so can acquisitions and consolidation. A merger
refers to the combination of two or more organizations into one larger organization or the
fusion of two or more companies, as distinct from the *take-over* of one company by
another. Such actions are commonly voluntary and often result in a new organizational
name. Acquisitions on the other hand, are the purchase of one organization by another.
Such actions can be hostile or friendly and the acquirer maintains control over the acquired

firm and acquisitions differ from a consolidation which is a business combination where
two or more companies join to form an entirely new company

Mergers may be undertaken for various reasons, notably to improve the efficiency of two complementary companies by rationalizing output and taking advantage of economies of scale, and to fight off unwelcome takeover bids from other larger companies. The companies involved form one new company and their respective shareholders exchange their holding for shares in the new concern at an agreed rate. From a business perspective, a merger is simply the consolidation of two or more companies into one. Merger" presupposes the existence of two independent things or estates, the greater of which would swallow up the lesser one by the process of absorption.

## 2.0 OBJECTIVES

At the end of this unit, students should be able to:

1. Understand what Mergers and Acquisitions are
2. Be knowledgeable about Mergers and Mergers in Nigeria
3. Understand the Legal Framework of Mergers and Acquisitions

## 3.0 MAIN CONTENT

### 3.1 Types of Mergers

**1.** Horizontal mergers: A horizontal merger involves two firms operating and competing
in the same kind of business activity. Textiles firm merges raw materials firm.
2. Vertical mergers: Vertical mergers occur between firms in different stages of production operation. - Example: Helene Curtis and Unilever.
3. Conglomerate Mergers: Conglomerate mergers involve firms engaged in unrelated
types of business activity - Example: General Electric buying NBC television.
4. Concentric Mergers - Based on specific management functions whereas the conglomerate mergers are based on general management functions - Example: Citigroup (principally a bank) buying Salomon Smith Barney (an investment banker/stock brokerage operation.

### 3.2 Mergers and Acquisitions in the Globe

Mergers and acquisitions (M&A) activities rose to a global record of US$3.8Trillion in 2006. This marked an increase of over thirty-five percent from year 2005, and surpassed the previous high of US$3.4Trillion set in year 2000 during the previous M&A boom. Many of these transactions were cross-border. In a study conducted in 2000 by Lehman Brothers and another in 2010 by Morgan Stanley, it was found that, on average, large M&A deals cause the domestic currency of the target corporation to appreciate by one percent relative to the acquirer's. Lien argues that for every $1 Billion deal, the currency of the target corporation increased in value by 0.5%. More specifically, the report found that in the period immediately after the deal is announced, there is generally a strong upward movement in the target corporation's domestic currency (relative to the acquirer's currency). Fifty days after the announcement, the target currency is then, on average, 1% stronger.

The rise of globalization has exponentially increased the market for cross border M&A. In 1996 alone there were over 2000 cross border M&A transactions worth a total of approximately $256 billion. This rapid increase took many M&A firms by surprise because the majority of them never had to consider acquiring the capabilities or skills required to effectively handle this volume of transactions. In the past, the market's lack of significance and a stricter national mindset prevented the vast majority of small and mid-sized companies from considering cross border intermediation as an option which left M&A firms inexperienced in this field. This same reason also prevented the development of any extensive academic works on the subject.

Cross-border intermediation has many more levels of complexity to it namely corporate governance, the power of the average employee, company regulations, political factors, customer expectations and cultures, all crucial factors that could affect the transaction.

**3.3 Mergers and Acquisitions in Nigeria – 29 Years After**

The year 1982 was a landmark year in the history of mergers and acquisitions in Nigeria. Prior to 1982 the concept of mergers and acquisitions had minimal actual significance in Nigeria. One of the very few major mergers that took place before that time was the amalgamation of three companies- Re Bendel Co Ltd, Bendel Intra-city Bus Service Ltd and Trans-Kalife Ltd- to form the Bendel Transport Service Ltd. This situation changed significantly after the Securities and Exchange Commission (SEC) began its operations in 1982, marking the beginning of regulated business combinations in Nigeria. The first merger attempt was in 1982 between United Nigeria Insurance Company Limited and United Life Insurance Company Limited, which was, however, not consummated. Between 1982 and 1988, The Securities and Exchange Commission supervised thirteen mergers- including the mergers of Lever Brothers Nigeria Limited and Lipton Nigeria Ltd, SCOA Nigeria Ltd and Nigeria Automotive Components Ltd, John Holt Ltd and John Holt Investment Ltd- only two of which were unsuccessful.

The prospects of mergers and acquisitions in Nigeria have continued to evolve since then. Different legislation have been passed to regulate business combinations, including the Companies and Allied Matters Act of 1990 and the *Investment and Securities Act* of 2007, as well as some sector-specific Acts, such as the Banking and other Financial Institutions Act of 1991, the Insurance Act of 2003 and the Electric Power Sector Reform Act of 2005. In 2002, there was a merger of two important petroleum companies; Agip Nigeria Plc and Unipetrol Plc to form Oando Plc.

### 3.4 The Legal Framework of Mergers and Acquisitions

In Nigeria the legislations that have impact, directly or indirectly on mergers and acquisitions in Nigeria are:

1. The Investments and Securities Act (ISA) 2007 and the Rules and Regulations of the Securities and Exchange Commission (SEC) made pursuant to the ISA.
2. The Companies and Allied Matters Act (CAMA) 2004.
3. The Companies Income Tax Act 2004.

In addition, there are other sector-specific laws that regulate business combinations. The Banks and other Financial Institutions Act (BOFIA) regulates the banking industry; the Nigerian Telecommunications Act 2003, regulates the telecommunications industry; the Insurance Act 2003 regulates the insurance industry; the Electric Power Sector Reform Act 2005 regulates the electric power sector. Transaction agreements relating to business combinations are typically governed by Nigerian law which has its roots in English common law. The parties to such agreements may, however provide for the law of any other jurisdiction to govern the agreement, especially where the M&A has cross border dimensions.

## 4.0 CONCLUSION

A merger can happen when two companies decide to combine into one entity or when one company buys another. An acquisition always involves the purchase of one company by another. The functions of synergy allow for the enhanced cost efficiency of a new entity made from two smaller ones - synergy is the logic behind mergers and acquisitions.

Mergers and acquisitions are crucial to the growth and health of an economy being a
highly attractive means for business owners and entrepreneurs to get value from the
wealth they have contributed in creating. The companies involved form one new

company and their respective shareholders exchange their holding for shares in the new
concern at an agreed rate. Mergers can fail for many reasons including a lack of management foresight, the inability to overcome practical challenges and loss of revenue
momentum from a neglect of day-to-day operations.

## 5.0 SUMMARY

In this unit we have discussed;

1. Mergers and Acquisitions in Nigeria and in the globe.
2. Defined the term Mergers and Acquisitions.
3. Examined the legal framework regulatory bodies in charge of Mergers and Acquisitions,

We also explained the effect of Mergers and Acquisitions in an organization and reasons why such fails in an organization.

We shall proceed to examine reasons for, Opportunities and Avoiding the Pitfalls in
Mergers and Acquisitions in next unit.

## 6.0 TUTOR-MARKEDASSIGNMENT

a) Define Mergers and acquisitions?

b) Explain the development of Mergers and Acquisitions in the Globe?

c) Give accounts on the Legal Framework of Mergers and Acquisitions.

## 7.0 REFERENCES/FURTHER READINGS

Bataille, G. (1985). “Nietzsche and the fascists.”In *Georges Bataille Visions of excess. Selected writings, 1927-1939* (translated by A. Stoekl). Minneapolis: University of Minnesota Press.

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Mergers & Acquisitions: Identifying the Opportunities & Avoiding the Pitfalls: FABIAN AJOGWU, SAN

## UNIT 3: MERGERS AND ACQUISITIONS: OPPORTUNITIES AND AVOIDING THE PITFALLS

CONTENTS

1.0 Introduction
2.0 Objectives
3.0 Main Content
  3.1 Reasons for Mergers
  3.2 Market Competition Factors
  3.3 The Procedure for Mergers in Nigeria
  3.4 Avoiding the Pitfalls
  3.5 The M and A Deal Closure
4.0 Conclusion
5.0 Summary
6.0 Tutor-Marked Assignment
7.0 References/Further Readings

### 1.0 INTRODUCTION

**Meaning of Mergers**

A merger connotes the combination of two companies into one larger company for some economic or other strategic reasons. It is defined as a transaction in which corporations of relatively equal size, combine It is also seen as a transaction in which two or more corporations combine under state corporation law, with the result that all but one of the participating corporations lose its identity. Sherman and Hart describe a merger as a combination of two or more companies in which the assets and liabilities of the selling firm(s) are absorbed by the buying firm. Although the buying firm may be a considerably different organization after the merger, it retains its originality.

Mergers can be defined from a broad as well as a narrow perspective. From a broad perspective, a merger is simply any takeover of one company by another, whereby the businesses of both companies are brought together as one. The management of both companies is then fused into one. Coyle defines it from a narrow perspective define merger as coming together of two companies of roughly equal size, pooling their resources into a single business. The stockholders or owners of both pre-merger companies have a share in the ownership of the merged business and top management of both companies continues to hold senior management positions after the merger.
A merger is defined under the *Investment & Securities Act* as the amalgamation of the undertakings or any part of the undertakings or interest of two or more

companies or the undertakings or any part of the undertakings or interest of one or more companies and one or more bodies corporate.

## 2.0 OBJECTIVES

At the end of this unit, students should be able to:

1. Demonstrate knowledge on reasons Mergers and Acquisitions
2. Be knowledgeable about Procedure for Mergers in Nigeria
3. Understanding and avoiding the Pitfalls of – The Twin Issue of Due Diligence and Valuation.

## 3.0 MAIN CONTENT

### 3.1 Reasons for Mergers

There are many reasons for companies wanting to acquire other companies. These reasons include the pursuit of a growth strategy, the defense of hostile action from another would-be acquirer, and financial opportunities. However, the commonest reason is that the merger will result in substantial trade advantage or greater profits than the combined profits of the two companies working separately. There is also the element of synergy. For instance, laying out the reason for the merger between United Bank for Africa Plc and Standard Trust Bank Plc, the Chairman of United Bank for Africa Plc stated as follows;

The primary objective of the merger is to create the No. 1 bank in West Africa and one of the largest Banks in sub Saharan Africa with a formidable asset base, offering a full spectrum of banking services from basic products and services for the low income personal market to customized solutions for the commercial and corporate market. The combined entity upon completion of the merger will have total assets of NGN365 Billion, over 360 branches spread across all the states of the country and a market Leadership position within the sub-regional banking industry.

Mergers and acquisitions may enable a company acquire a competitor which poses substantial threat to it, or a company which supplies its raw materials or provides it with market outlets with the aim of assuring, improving these services, or ensuring that these companies are not taken-over by a competitor. Again, the motivation may be diversification of enterprises with a view to ensuring stability of earnings; and it may be to acquire the much-needed technology or managerial expertise of another company.

There are reasons for going the route of mergers, which have been considered to primarily add to shareholder value. They are as follows: -

1. Economies of Scale: This refers to the fact that the combined company can often reduce duplicate units or operations, lowering the costs of the company relative to

the same revenue stream, thus increasing profit. In the United Bank for Africa Plc merger, the Scheme cited economies of scale as benefit, when it stated thus: the combined institution will create economies of scale that will result in a reduction in costs and the utilization of the synergies between the two institutions to streamline the operations of the post –merger UBA.

2. Increased Revenues/ Increased Market Share: This motive assumes that the company will be absorbing a major competitor and thus increase its power (by capturing increased market share) to set prices. This was laid out as a driver in the UBA merger

through the merger, the combined bank will be better able to compete with institutions within Nigeria, the Sub-Saharan Africa region and internationally, thereby increasing market share, surpassing the competition and consequently increasing gross revenue.

3. Cross Selling: For example, a bank buying a stock broker could then sell its banking products to the stock broker's customers, while the broker can sign up the bank's customers for brokerage accounts, or a manufacturer can acquire and sell complementary products.

4. Synergy: Better use of complementary resources. Excluding any synergies resulting from the merger, the total post-merger value of the two firms is equal to the pre-merger value. However, the post-merger value of each individual firm likely will be different from the pre-merger value because the exchange ratio of the shares probably will not exactly reflect the firms' values with respect to one another. The exchange ratio is often skewed because the target firm's shareholders are paid a premium for their shares.

Synergy takes the form of revenue enhancement and cost savings. When two companies in the same industry merge, such as two banks, combined revenue tends to decline to the extent that the businesses overlap in the same market and some customers become alienated. For the merger to benefit shareholders there should be cost saving opportunities to offset the revenue decline; the synergies resulting from the merger must be more than the initial lost value. In citing operational efficiency as one of the envisaged benefits of the merger between Dangote Cement Plc and Benue Cement Plc, the Chairman stated: The merger will result in greater operational integration between Dangote Cement Plc and Benue Cement Plc and make the consolidation of their supply and distribution chain more effective. Following the merger, BCC and DCP will be able to share facilities, inventory and other resources.

5. Taxes: A profitable company can buy a loss maker to use the target's loss as their advantage by reducing their tax liability. In the United States and many other

countries, rules are in place to limit the ability of profitable companies to "shop" for loss-making companies, limiting the tax motive of an acquiring company.

6. Geographical or other diversification: This is designed to smooth the earnings results of a company, which over a long term, smoothens the share price of a company, giving conservative investors more confidence in investing in the company. However, this does not always deliver value to shareholders (see below). This was also cited as one of the drivers of the merger of United Bank for Africa Plc – the combined institution will facilitate geographical expansion into markets where we had not previously had a presence. As a result, the combined bank will be able to decrease total risk, increase product sales and thus increase overall gross revenue.
7. Resource Transfer: Resources are unevenly distributed across firms and the interaction of target and acquiring firm resources can create value through either overcoming information asymmetry or by combining scarce resources.

8. Increased market share which can increase market power: In an oligopoly, increased market share generally allows companies to raise prices. Note that while this may be in the shareholders' interest, it often raises antitrust concerns, and may not be in the public interest.

The reasons for a merger could also be appreciated from the perspective of the seller. The reasons include;

1. The seller could be approaching retirement or getting ready for an exit out of the business.
2. The need for competent management or managers that could lead the business to the next level i.e. sustain it.
3. The business could require substantial investment in new technology and business processes to enhance its competiveness.
4. The need for access to the target's resources coupled with the need for liquid assets to augment working capital, and meet critical obligations of the company.

The reasons for merging could also be appreciated from the buyer's perspective. The reasons would include;

1. The need to enhance revenues, and reduce the operation costs relative to the revenues, in essence to increase the earnings per share (EPS). Mergers in which the acquiring company's earnings per share (EPS) increases is known as "accretive mergers". An alternative way of calculating this is if a company with a high price to earnings ratio (P/E) acquires one with a low P/E. The corollary of accretive mergers is „dilutive mergers,‟ whereby a company's EPS decreases. The company will be one with a low P/E acquiring one with a high P/E.

2. Backward or vertical integration (vertical or horizontal operational synergies) or economies of scale.
3. The need to acquire new technologies, business processes, production capacity and management capabilities.
4. Strengthening management capabilities.
5. Change in the overall direction of the business.

A merger decision could also be driven by its business objectives at the time, such as market leadership in the form of geographical market leadership, within a country, a group of countries or globally. It could also be driven by the need for technological leadership; or for providing high quality service or innovation or simply being the lowest cost producer in the industry.

The Securities and Exchange Commission (SEC) is charged with the statutory responsibility of considering the desirability or otherwise of a merger from the point of view of the public interest or greater good to the society or economy. This responsibility is exercised with clearly defined criteria and factors to be taken into consideration in arriving at a decision whether or not the merger is against public interest. Whenever required to consider a merger, the SEC is required to initially determine whether or not the merger is likely to substantially prevent or lessen competition, by assessing the factors set out in section 121, subsection (2) of the ISA. If it appears that the merger is likely to substantially prevent or lessen competition, then the SEC will determine - whether or not the merger is likely to result in any technological efficiency or other pro-competitive gain which will be greater than, and off-set, the effects of any prevention or lessening of competition, that may result or is likely to result from the merger, and would not likely be obtained if the merger is prevented, and… whether the merger can or cannot be justified on substantial public interest grounds by assessing the factors set out in subsection (3);

In considering the merger, the SEC is required to determine whether all the shareholders of the merging entities are „fairly, equitably and similarly treated and given sufficient information regarding the merger‟. When determining whether or not a merger is likely to substantially prevent or lessen competition, the SEC is required to assess the strength of competition in the relevant market, and the probability that the company, in the market after the merger, will behave competitively or co-operatively, taking into account any factor that is relevant to competition in that market.

### 3.2 Market Competition Factors

The factors that should be taken into account as being relevant to competition in that market are:

(a) The actual and potential level of import competition in the market;

(b) The ease of entry into the market, including tariff and regulatory barriers;
(c) The level and trends of concentration, and history of collusion, in the market;
(d) The degree of countervailing power in the market;
(e) The dynamic characteristics of the market, including growth, innovation, and product differentiation;
(f) The nature and extent of vertical integration in the market;
(g) Whether the business or part of the business of a party to the merger or proposed merger has failed or is likely to fail; and
(h) Whether the merger will result in the removal of an effective competitor.

When determining whether a merger can or cannot be justified on public interest grounds, the SEC is required to consider the effect that the merger will have on a number of issues
(a) A particular industrial sector or region;
(b) Employment;
(c) The ability of small businesses to become competitive; and
(d) The ability of national industries to compete in international markets.

### 3.3 The Procedure for Mergers in Nigeria

Preliminary Considerations
The formalities of a merger usually include the following steps:
a) The company may execute a Memorandum of Understanding which spells out the understanding of the parties and "sets the stage for honest and confident negotiation and anticipates the future steps to be taken by the parties". This document is not subject to regulation by the Securities and Exchange Commission. The management of the acquiring and target companies will reach a preliminary agreement.

b) The Board of directors of both companies would then adopt a merger agreement. Both companies must notify their respective shareholders of the terms of the proposed merger and the shareholders must approve the transaction by majority vote.

c) Notification and voting materials usually are provided to shareholders of public companies as part of proxy statements required by statutory instrument. The proxy statements will include the terms of the merger, the consideration that will be offered to the target's shareholders and information about the two companies. These considerations may include stocks and shares or other securities in the acquiring company, debentures, or cash.

d) If the merger is approved by the required number of shares, the shareholders of the merging company will exchange their stocks for the pre-negotiated consideration.

All shareholders must be entitled to receive equal consideration of each of their shares. However a choice of the form of consideration is sometimes permitted.

### 3.4 Avoiding the Pitfalls – The Twin Issue of Due Diligence and Valuation

The two main pitfalls arise from two main issues - the lack of or improper Due Diligence, and Valuation. It is not intended to discuss the issue of valuation in this paper, for reasons of limitations of space and time. Due diligence is the set of investigative procedures which precede an acquisition or a merger. It is the process of identifying and confirming or disconfirming the business reasons for a proposed capital transaction. The purpose of due diligence investigation is to enable the purchaser gain sufficient familiarity with the target's affairs to assess the risks involved in the purchase. It is prudent to perform due diligence before the execution of any mergers or acquisitions.

Due diligence determines the accuracy of information disclosed by the merging, selling or buying company before the consummation of the transaction in order to avoid any troubles with future business through identification of crucial issues, resolution on contentious facts and confirmation of key assumptions. When risks are adequately identified, the transacting parties can determine the realisation or otherwise of the transaction and project on the appropriate means to execute the acquisition or merger agreement. Several functions are involved in due diligence processes- business strategy, finance, legal, marketing, operations, human resources, and internal audit services. The direction of due diligence efforts depends on what the company expects to gain from the transaction: employees, customers, processes, products, or services.

Due diligence involves the complete awareness of the transacting parties on issues delving on the cost of the merger or acquisition, the consequences of negative disclosures, the likelihood of litigation or other unexpected conflict, risks associated with the personal misconduct of the selling parties(e.g. insider trading, self-dealing, fraud etc). Due diligence also allows the seller and buyer to renegotiate the price if the buyer determines that there are problems with information (value of assets, likelihood of lawsuits, robustness of technology, etc.) or certain projections are unrealistic.

### 3.5 The M and A Deal Closure

The closing of a merger or acquisition usually brings a great sigh of relief to the buyer, seller and their respective advisors. Everyone has worked hard to ensure that the process went smoothly and that all parties are happy with the end result. But the term closing can be misleading in that it suggests a sense of finality, when in truth the hard work, particularly for the buyer, has just begun.

One of the major issues with the closing stage is the project staffing level. The first step in determining project staffing level is to divide the work-force into management

and staff/ labour. These two groups must be distinguished because the terms of employment are often quite different. Management is often party to employment contracts, and receives deferred compensation, share options, and other issues, while staff can be protected by union contracts and/ or employment laws. In many ways, management staffing is a much easier problem to resolve. The primary task of resolving the level of management staffing is to determine where there are redundancies and who the most qualified candidates are.

Following the closing of the transactions, there are many legal and administrative tasks that must be accomplished by the acquisition team to complete the transaction. The nature and extent of these tasks will vary, depending on the size and type of the financing method selected by the purchaser. The parties to any acquisition must be careful to ensure that the jubilation of closing does not cause any post-closing matters to be overlooked.

In an asset acquisition, these post-closing tasks typically include the following:

- Final verification that all assets acquired is free of liens and encumbrances
- Recording of financing statements and transfer tax returns
- Recording of any assignments of intellectual property with the appropriate authority
- Notification of the sale to employees, customers, distributors, and suppliers
- Adjustment of bank accounts and insurance policies
- Completion of the transfer of all share certificates
- Amendments to the company's memorandum and articles of association
- Preparation of all appropriate post-closing minutes and resolutions.

## 4.0 CONCLUSION

Many companies find that the best way to get ahead is to expand
ownership boundaries through mergers and acquisitions. For others, separating the public
ownership of a subsidiary or business segment offers more advantages. At least in theory,
mergers create synergies and economies of scale, expanding operations and cutting costs.
Investors can take comfort in the idea that a merger will deliver enhanced market power.
By contrast, de-merged companies often enjoy improved operating performance thanks to
redesigned management incentives. Additional capital can fund growth organically or
through acquisition. Meanwhile, investors benefit from the improved information flow
from de-merged companies.

Mergers and Acquisitions (M&A) comes in all shapes and sizes, and investors need to consider the complex issues involved in M&A. The most beneficial form of equity structure involves a complete analysis of the costs and benefits associated with the deals.

The terms “Mergers” and “Acquisitions” are often used interchangeably to mean the same thing, and in a more common sense used in the twin form of „mergers and acquisitions‟. Acquisition describes the act of gaining effective control over the assets or management and ownership (of shares in the capital) of another company without any combination of companies. A merger decision could also be driven by its business objectives at the time, such as market leadership in the form of geographical market leadership, within a country, a group of countries or globally. It could also be driven by the need for technological leadership; or for providing high quality service or innovation or simply being the lowest cost producer in the industry.

## 5.0 SUMMARY

We have discussed the procedures for Mergers and Acquisitions, the reasons for merging from the seller and buyer’s perspective has been examined. The various regulatory bodies and their individual roles in mergers and acquisition process have been discussed. The reasons for Mergers and Acquisitions and some of the pitfalls were also examined. This unit focused on citation of merger and acquisition meaning, reasons for merger, the competitive factors and the procedure for organization merger and acquisition in Nigeria. The various steps to formalities of mergers were considered.

The next unit we shall examine challenges and regulatory authorities of mergers and acquisitions.

## 6.0 TUTOR-MARKED ASSIGNMENT

a) What is The Procedure for Mergers in Nigeria?
b) Explain the Twin Issue of Due Diligence and Valuation.
c) Give Reasons for Mergers.
d) Highlights step in formalities of a merger.

## 7.0 REFERENCES/FURTHER READINGS


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## UNIT 4 MERGERS AND ACQUISITIONS: CHALLENGES AND REGULATORY AUTHORITIES

## CONTENTS

1.0 Introduction
2.0 Objectives
3.0 Main Content
    3.1 Issues and Challenges in M&A
4.0 Conclusion
5.0 Summary
6.0 Tutor-Marked Assignment
7.0 References/Further Readings

### 1.0 INTRODUCTION

The Nigerian banking system and indeed, the entire nation's financial system has its share of the global financial crisis. In addition to the effect of the global financial crisis on the Nigerian financial system, the challenges posed by the banking consolidation programme that was concluded in 2005 and other developments within the economy, made the nation to experience another round of financial crisis in 2008/2009, as revealed by the CBN/NDIC joint Special Examination carried out in 2009. The Examination result among others that 10 of the 24 deposit money banks were in grave financial condition. The findings from the examination led to the removal of eight (8) CEOs of the distressed banks and members of their executive management teams and their replacement with new executive managements appointed by the CBN. The CBN also injected N620 billion in the affected banks as tier 2 capital. Out of the 10 banks, owners of Wema Bank and Unity Bank Plc were able to adequately re-capitalize their banks. The efforts of The Regulatory Authorities to ensure that the remaining eight banks were recapitalized were stalled by various court injunctions obtained by the shareholders of the banks. In order to address that challenge, The CBN gave the banks a deadline of 30th September, 2011 to recapitalize or have their licenses revoked.

### 2.0 OBJECTIVES

At the end of this unit, students are expected to understand:

1. Issues and challenges in M&A
2. The current trend in M&A in the Nigerian banking industry
3. Financial safety nets and Regulatory Authorities.

## 3.0 MAIN CONTENT

### 3.1 Issues and Challenges in M&A

The first experience of M & A in Nigeria took place during the banking consolidation programme of 2004/2005. The recent M & A transactions for 4 of the intervened banks were largely driven by the need to address their deficient capital positions. The transactions were largely assisted by the Regulatory Authorities through the provision of technical support in the form of advice. While the development is expected to resolve the problems of the intervened banks, there are obvious issues and challenges that should be addressed both by the Regulatory Authorities and operators in order to derive maximum benefits from the outcome of the transactions.
Some of these issues and challenges are highlighted below.

**Payments System Efficiency**

As M & A has the direct effect of positively affecting the payments system by improving scale efficiencies in bank office payments operations as larger processing sites may yield scale efficiencies in processing payments information/instruments. In addition, many of the remaining inter-bank payments may be cleared more quickly and efficiently because there are fewer end points to which to send payment information or payment instruments. Thus, even if individual institutions are not more proficient in handling cheques, credit card, debit cards, automated clearing system, wire payments, etc, the payments system efficiency increases as the number of institutions declines.

The issue that arises in this regard is how quickly the merging entities are able to integrate into a formidable entity that can produce scope and scale economies in the payments system. It is however, worthy of note to indicate that since all the affected banks are products of M & A of the recent consolidation programme, they will bring their experience to bear in this regard. The Regulatory Authorities should, however, pay close attention to the integration process with a view to quickly detecting problems when they occu rand proffering remedies to address such problems.

**Distress Resolution**

M & A transactions are usually encouraged as they serve as an efficient way of resolving problems of financial distress. Institutions that are troubled because of their own inefficiency or underperforming investments are often taken over as an efficient alternative to bankruptcy or other means of exit. In that type of situation, the ideal merger would be for the ailing financial institution to be merged with a

conservatively leveraged one that has a complementary mix of financial products, services and target markets. In the United States, the Federal Home Loan Bank System had arranged the mergers of a number of large “problem” savings and loan associations into sound institutions, and the Federal Reserve System had done same for banks.

While that may be desirable, the possibility that the depth of distress of the weaker bank may adversely affect the soundness of the healthier one remains an issue of concern to the Regulatory Authorities. The comfort in this regard is that the exact depth of distress in all the affected weak banks was unearthed by the Management teams of the respective banking institutions that were appointed by the Regulatory Authorities and the financial advisers.

**Range of Product Lines Available to Consumers**

Successful M & A transactions should potentially be in the public interest, particularly in the area of service delivery as the outcome is expected to add some depth to the local banking sector and make a worthwhile contribution to banking services and the banking industry in a particular country.
A frequent factor in motivating mergers is the possibility of scope efficiencies. The pursuit of these efficiencies often results in the product lines of the two entities being rationalized, with consequent cost benefits, since a single delivery system is used to sell a “better”(bigger) range of products. This often increases the options that consumers have and enhances the utility of these options.
Furthermore, economies of scale are fairly likely to improve after successful M & A. larger transaction volumes and larger asset positions, through a rationalized delivery system, mean that unit costs can be reduced. When such cost reductions are passed on to the consumers, this may be regarded as a public interest benefit.

The challenge here is that the development may compound the oligopolistic structure of the market where only a few banking institutions dominate and dictate quality and prices of products and services offered to consumers. It is instructive to note that when banks merge, the number of players will reduce and hence, the intensity of competition. This might have implications for the prices, products and quality of services in the banking sector. In addition, the reduction in the level of competition, which is a direct result of M& A, implies that there may be less need for innovation, with possible less research and development spending and, which might adversely affect potentials for future growth and development at desirable rates.
Furthermore, M & A can easily result in a substantial increase in the market power of a bank. Despite the fact that a merger, for instance, is often being motivated on grounds of economies of scale and cost containment, shareholders’ interests also drive mergers, and the cost savings may not always be passed onto customers. In

addition, the possibility exists that the increased market power might be abused by the emerging entity, raising costs to customers to unacceptable levels.
In that regard, rather than deriving benefits arising from scope and scale economies of the emerging large entities, consumers may be getting less quality products/services at higher prices. Regulatory Authorities should therefore put in place stricter regulation for banking products and service delivery to minimize possible abuses and they should equally strengthen supervision to ensure compliance.

### 3.1.4 Confidence in the Banking System

Banks, although stringently regulated, are prone to runs. This is because they are known to be highly geared. Confidence is therefore crucial for banks to attract and retain deposits. Big banks have been observed to be less vulnerable to external shocks. It could therefore, be said that big banks enhance the confidence of the public. Since M& A is expected to lead to the creation of large and strong banks, confidence in the nation's banking system is likely to be enhanced and this in turn may lead to improvement in banking habits of the populace thereby enhancing the efficacy of monetary policy.
The challenge is that the development my lead to the creation of significantly important financial institutions (SIFIs) which may take the features of too-big-to-fail institutions.

The concerns of regulatory and supervisory agencies have been that the impact of a large bank failing will challenge the issues of moral hazards, systemic risk and impede the achievement of their mandate. There is the need therefore, to put in place additional measures to cope with the too big-to-fail problem.

The objectives of regulatory/supervisory agencies in this regard are basically three, namely:
i. To reduce the possibility of failure of large banks (also called Global Systematically Important Banks (G-SIBs);
ii. To reduce the extent or impact of the failure of such banks in the unlikely event of its occurrence; and
iii. Provide a level playing field by reducing the competitive advantage in funding markets that these institutions have.

In line with practices in other jurisdictions, particularly in Europe, America, Japan and emerging economies in the Eastern block, the following measures could be considered for adoption by the Regulatory Authorities in order to achieve the above-listed objectives of addressing the too-big-to-fail problem.

a. Reducing the Probability of Failure

The cornerstone of regulatory/supervisory response to the problem was the raising of the amount of capital requirement for this category of banks through the application of capital surcharge, which has the possibility of lowering the risk of failure by enhancing their resilience to shocks. Jurisdictions that have started taking such measures by requiring even higher minimum capital for this category of banks, have categorized banks in their jurisdictions using size, interconnectedness, global activity, substitutability and complexity.

b. Reducing the Impact of Failure

One way of reducing the impact of failure of big banks is to reduce their systemic importance directly by regulatory/supervisory measures. Such measures may include placing limitations on the size or business activities by separating core banking services from other speculative investment activities and proprietary trading operations.

c. Leveling the Playing Field

The distortion to the level-playing-field created by funding advantages by banks perceived to be too-big-to-fail has remained an issue of concern to regulators and other key stakeholders. Several attempts have been made to quantify such funding advantages and the general conclusion has been that the advantage is huge.
Measures such as capital surcharge, restrictions on certain business activities and imposition of special recovery and resolutions regimes, such as creation of living will and direct policy intervention, are often put in place for the big banks to help reduce the undue advantage by making transactions in the market fairer for small banks which could ensure the creation of a level playing field.

d. Access to Financial Services by Small Firms

Typically, small banks lend a larger proportion of their assets to small businesses than do large banks. The large institutions created through M & A transactions may shift away from providing retail oriented services for small depositors and borrowers because of new opportunities to provide wholesale services for large capital market participants. This is because it may be scope inefficient for the emerging large banking entity produce outputs/services that are suitable for small businesses because diseconomies may most likely arise in providing services to informational opaque small businesses.
In the main, M & A may inadvertently eliminate small banks, thereby raising the concern that small firms may find it difficult to access banking services. In view of the strategic importance of small businesses in the development process of any

nation, the need to strengthen the non-bank financial institutions, particularly microfinance banks that are capable of rendering services to this group of economic agents has become imperative.

e. Staff Rationalization

In a service industry such as banking, motivation of staff is a key factor in ensuring that efficiency is maintained. When banks merge, there is the tendency that jobs might be lost as part of their positioning strategies the new management may want to undertake. Apart from the adverse impact on employment level, the development could also impact negatively on the morale of the remaining workforce. This development should be envisaged, at least in the short-run, hence appropriate strategies must be put in place by the new managements of the emerging banks to boost the morale of staff. In addition, adequate attention should be given to trade unions in the industry in order to minimize disruptions from their activities which rationalization of staff might inadvertently prompt.
The adverse effects on employment is, however, expected to wane with time as a stronger banking sector would inevitably recruit more staff when the respective banks grow and open new branches. In addition, the induced employment generation from the real sector of the economy might more than compensate for job loss, net of attrition, after a successful M & A.

f. Effectiveness of IT Architecture

The effectiveness of IT system might be impaired, at least in the short-run. IT systems should be able to provide management information that is accurate, timely and relevant to managing a bank's risks. IT is most probably the biggest risk if not properly planned and managed. For example, there could be a lack of management information, an increased possibility of fraud and incorrect measurement of risk, since manual intervention is required until proper IT systems are in place.
In the long run however, successful M & A transactions are expected to lead to the deployment of highly sophisticated IT systems that would be of immense advantage to the industry in particular and the economy in general.

g. Executive Capacity

Management of banks should be fit and proper, competent, adequately skilled and prudent. The ability of executive management to build and mould a management team that is able to lead the emerging banking entity after M & A through the painful process of merging IT systems, business lines and products, cultures and people of critical importance. In that regard, the management of the emerging entity needs to have the ability to identify the integration risks at an early stage and manage them effectively in the shortest possible time.

h. Financial Safety Net

Given the importance of banks to the economy, their inherent fragility and the devastating and painful consequences of bank failure, most governments put in place safety nets. Financial safety nets are a set of rules and institutions that will ensure a safe, sound and stable banking system. They are usually made up of effective supervision, lender-of-last-resort role of central banks and deposit insurance.

The current trend in M & A in the Nigerian banking industry will raise the following issues in the three components of the safety net.

a. Regulation and Supervision

The on-going M & A in the banking industry, will undoubtedly, lead to the emergence of large banking entities. The development will necessarily entail strengthening of the subsisting regulatory/supervisory framework.
In particular, strong prudential regulation that will introduce additional capital surcharge for large banks and periodic review of fit-and-proper test results has become more imperative than hitherto. Similarly, there is the need to develop guidelines for the development of special resolution regime framework for systemically important banks so as to reduce the problem of moral hazard as well as minimize utilization of public funds to bail out banks. In addition, fine-tuning of the framework for risk-based and consolidated supervision, ensuring compliance with the recently issued guidelines on accounting and disclosure regimes and effective self-regulation may be unavoidable so as to promote market discipline. It is instructive to note that the recent banking reform has addressed these imperatives but efforts should be made to sustain the momentum. In the case of risk- based and consolidated supervision, the current efforts of the CBN/NDIC in upgrading the electronic Financial Analysis Surveillance System (e-FASS) and the activities of the Financial Services Regulation Coordinating Committee (FSRCC) would go a long way to assist in this regard.

Furthermore, in view of the fact that M & A would create large and sometimes complex banks, statutory regulation should be complemented by self-regulation. Effective self-regulation requires probity, transparency and accountability. The regulatory/supervisory authorities should take necessary steps to encourage these virtues and operators must be made to appreciate the need for compliance with rules and regulations to promote healthy competition since self-regulation does not amount to a total elimination of regulatory controls and supervision.

In addition, consideration should always be given to the possibility that corporate governance, in particular internal control systems, will be less effective during a merger, since the individuals' responsible for governance and control will be focusing on strategic issues relating to the merger. Regulatory/supervisory authorities must therefore, continue to encourage the enthronement of responsive corporate governance structure for effective risk management both during and after M & A by banks.

b. Deposit Insurance

As a deposit protection agency, NDIC is concerned with putting in place appropriate strategies to ensure adequate depositor protection in the banking industry both during and after M & A transactions. In order to adequately protect depositors, contribute to the stability of the banking system and reduce the problem of moral hazard often associated with deposit insurance, some specific deposit insurance design features as being applied by the NDIC may have to be reviewed to enhance the effectiveness of the Corporation. These features, some of which are already in place, include the following:

Placing limits on the amounts insured as currently being done but the limits should be
periodically reviewed to ensure their adequacy in engendering confidence;
Excluding certain categories of depositors from coverage: this is also the practice in
Nigeria; Fine-tuning the subsisting differential premium assessment system to make it more effective in promoting sound risk management in banks; Minimizing the risk of loss by adopting prompt corrective action and employing least
costly failure resolution option as demonstrated recently when bridge bank option was
adopted. That has implication for capacity building in the relevant areas; and
Demonstrating a willingness to take legal action, where warranted, against directors and
others for improper acts.

C. Lender-of-Last-Resort Facility

With the emergence of bigger banks arising from the on-going M & A in the industry, the CBN should stand ready to provide temporary liquidity to deserving banking institutions so as to avoid devastating damage to the entire banking system. However, a lot of care should be exercised by the CBN so as to avoid making itself lender-of-first resort with a view to promoting sound and prudent bank management.

**4.0 CONCLUSION**

In the unit, we have attempted to highlight some issues and challenges on M & A in the banking industry. In the main, the unit has provoked the managements of the emerging bigger banking institutions to brace up to the challenges and run their banks in a safe and sound manner. In that regard, they should enhance their risk management capacity, enthrone responsive corporate governance, embrace the right culture that would promote market discipline and should complement statutory regulation with self-regulation and self-discipline. The Regulatory/Supervisory Authorities should be more proactive in the discharge of their role which implications for capacity building in all relevant areas.

## 5.0 SUMMARY

The purpose of this unit is to highlight issues and challenges in mergers and acquisition. The Nigerian banking system and indeed, the entire nation's financial system has its share of the global financial crisis. The next unit shall examine industrial Corporate Strategy.

## 6.0 TUTOR-MARKED ASSIGNMENT

a) Discuss the features of Deposit Insurance.

b) What are the objectives of regulatory/supervisory agencies?

c) Identify five challenges in M&A

## 7.0REFERENCES/FURTHERREADINGS


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## UNIT 5: CONCEPT OF CORPORATE STRATEGY

1.0 Introduction
2.0 Objectives
3.0 Main Contents
  3.1 What is Strategy?
  3.2 Why Corporate Strategy
  3.3 Levels of Strategy
  3.4 Strategic Approach

3.5. Corporate Strategy as ongoing process
4.0 Conclusion
5.0 Summary
6.0 Tutor-Marked Assignment
7.0 References/Further Readings

## 1.0 INTRODUCTION

Organizations are facing exciting and dynamic challenges in the 21st century. In the gloabalized business, companies require strategic thinking and only by evolving good corporate strategies can they become strategically competitive. A sustained or sustainable competitive advantage occurs when firm implements a value – creating strategy of which other companies are unable to duplicate the benefits or find it too costly to initiate. Corporate strategy includes the commitments, decisions and actions required for a firm to achieve strategic competitiveness and earn above average returns.

## 2.0 OBJECTIVES

At the end of this unit, students are expected to understand:

1. Reasons for Corporate Strategy
2. Type of Corporate Strategy
3. Financial safety nets and Regulatory Authorities.

## 3.0 MAIN CONTENT

3.1What is strategy?
Strategy is narrowly defined as "the art of the general" (the Greek stratos, meaning 'field, spread out as in 'structure'; and agos, meaning 'leader'). The term first gained currency at the end of the 18th century, and had to do with stratagems by which a general sought to deceive an enemy, with plans the general made for a campaign, and with the way the general moved and disposed his forces in war. Also was the first to focus on the fact that strategy of war was a means to enforce policy and not an end in itself. Strategy is a set of key decisions made to meet objectives. A strategy of a business organization is a comprehensive master plan stating how the organization will achieve its mission and objectives.

### 3.2 Why Corporate Strategy?

Strategic management is basically needed for every organization and it offers several benefits;

### 3.2.1. Universal

Strategy refers to a complex web of thoughts, ideas, insights, experiences, goals, expertise, memories, perceptions, and expectations that provides general guidance for specific actions in pursuit of particular ends. Nations have, in the management of their national policies, found it necessary to evolve strategies that adjust and correlate political, economic, technological, and psychological factors, along with military elements. Be it management of national polices, international relations, or even of a game on the playfield, it provides us with the preferred path that we should take for the journey that we actually make.

### 3.2.2. Keeping pace with changing environment

The present day environment is so dynamic and fast changing thus making it very difficult for any modern business enterprise to operate. Because of uncertainties, threats and constraints, the business corporations are under great pressure and are trying to find out the ways and means for their healthy survival. Under such circumstances, the only last resort is to make the best use of strategic management which can help the corporate management to explore the possible opportunities and at the same time to achieve an optimum level of efficiency by minimizing the expected threats.

### 3.2.3. Minimizes competitive disadvantage

It minimizes competitive disadvantage and adds up to competitive advantage. For example, a company like Hindustan Lever Ltd., realized that merely by merging with companies like Lakme, Milk food, Ponds, Brooke bond, Lipton etc which make fast moving consumer goods alone will not make it market leader but venturing into retailing will help it reap heavy profits. Then emerged its retail giant “Margin Free’ which is the market leader in states like Kerala. Similarly, the R.P. Goenka Group and the Muruguppa group realized that mere takeovers do not help and there is a need to reposition their products and reengineer their brands. The strategy worked.

### 3.2.4. Clear sense of strategic vision and sharper focus on goals and objectives

Every firm competing in an industry has a strategy, because strategy refers to how a given objective will be achieved. ‘Strategy’ defines what it is we want to achieve and charts our course in the market place; it is the basis for the establishment of a business firm; and it is a basic requirement for a firm to survive and to sustain

itself in today's changing environment by providing vision and encouraging defining mission.

### 3.2.5. Motivating employees

One should note that the labor efficiency and loyalty towards management can be expected only in an organization that operates under strategic management. Every guidance as to what to do, when and how to do and by whom etc, is given to every employee. This makes them more confident and free to perform their tasks without any hesitation. Labor efficiency and their loyalty which results into industrial peace and good returns are the results of broad-based policies adopted by the strategic management

### 3.2.6. Strengthening Decision-Making

Under strategic management, the first step to be taken is to identify the objectives of the business concern. Hence a corporation organized under the basic principles of strategic management will find a smooth sailing due to effective decision-making. These points out the need for strategic management.

### 3.2.7. Efficient and effective way of implementing actions for results

Strategy provides a clear understanding of purpose, objectives and standards of performance to employees at all levels and in all functional areas. Thereby it makes implementation very smooth allowing for maximum harmony and synchrony. As a result, the expected results are obtained more efficiently and economically.

### 3.2.8. Improved understanding of internal and external environments of business

Strategy formulation requires continuous observation and understanding of environmental variables and classifying them as opportunities and threats. It also involves knowing whether the threats are serious or casual and opportunities are worthy or marginal. As such strategy provides
for a better understanding of environment.

## 3.3 Levels of strategy

A typical business firm should consider three types of strategies, namely.
Corporate strategy – Which describes a company's overall direction towards growth by managing business and product lines? These include stability, growth and retrenchment.
For example, Coco cola, Inc., has followed the growth strategy by acquisition. It has acquired local bottling units to emerge as the market leader.
Business strategy - Usually occurs at business unit or product level emphasizing the improvement of competitive position of a firm's products or services in an industry or market segment served by that business unit. Business strategy falls in the in the realm of corporate strategy.
For example, Apple Computers uses a differentiation competitive strategy that emphasizes innovative product with creative design. In contrast, ANZ Grindlays merged with Standard Chartered Bank to emerge competitively.
Functional strategy – It is the approach taken by a functional area to achieve corporate and business unit objectives and strategies by maximizing resource productivity. It is concerned with developing and nurturing a distinctive competence to provide the firm with a competitive advantage. For example, Procter and Gamble spends huge amounts on advertising to create customer demand.

Operating strategy - These are concerned with how the component parts of an organization deliver effectively the corporate, business and functional -level strategies in terms of resources, processes and people. They are at departmental level and set periodic short-term targets for accomplishment.

**3.4 Strategic Approach**

There are basically four approaches to crafting a strategy
1. The Chief Architect approach A single person – the owner or CEO –assumes the role of chief strategist and chief entrepreneur, single handedly shaping most or all of the major pieces of strategy. This does not mean that one person is the originator of all the ideas underlying the resulting strategy or does all the background data gathering and analysis: there may be much brainstorming with subordinates and considerable analysis by specific departments.
The chief architect approach to strategy formation is characteristic of companies that have been founded by the company's present CEO. Michael Dell at Dell Computer, Steve Case at America Online, Bill Gates at Microsoft, and Howard Schultz at Starbucks are prominent examples of corporate CEOs who exert a heavy hand in shaping their company's strategy.
2. The Delegation Approach: Here the manager in charge delegates big chunks of the strategy-making task to trusted subordinates, down-the-line managers in charge of key business units and departments, a high-level task force of

knowledgeable and talented people from many parts of the company, self-directed work teams with authority over a particular process or function, or, more rarely, a team of consultants brought in specifically to help develop new strategic initiatives.

3. The Collaborative or Team Approach: This is a middle approach when by a manager with strategy-making responsibility enlists the assistance and advice of key peers and
subordinates in hammering out a consensus strategy. Strategy teams often include line and staff managers from different disciplines and departmental units, a few handpicked junior staffers known for their ability to think creatively, and near-retirement veterans noted for being keen observers, telling it like it is, and giving sage advice.

Electronic Data Systems conducted a year-long strategy review involving 2,500of its 55,000 employees and coordinated by a core of 150 managers and staffers from all over the world. Nokia Group, a Finland-based global leader in wireless telecommunications, involved250 employees in a strategy review of how different communications technologies were converging, how this would affect the company's business, and what strategic responses were needed.

4. The Corporate Intrapreneur Approach: In the corporate intrapreneur approach, top management encourages individuals and teams to develop and champion proposals for new product lines and new business ventures. The idea is to unleash the talents and energies of promising corporate intrapreneurs, letting them try out business ideas and pursue new strategic initiatives. Executives serve as judges of which proposals merit support, give company intrapreneurs the needed organizational and budgetary support, and let them run with the ball. W.L. Gore & Associates, a privately owned company famous for its Gore-Tex waterproofing film, is an avid and highly successful practitioner of the corporate intrapreneur approach to strategy making. Gore expects all employees to initiate improvements and to display innovativeness.

### 3.5. Corporate strategy asongoing process

Corporate strategy is a continuous ongoing process and extends companywide over adiversified company's business. It is a boundary spanning planning activity considering all theelements of the micro and macro environments of a firm. The following are the key tasks of theprocess of developing and implementing a corporate strategy.

i. Exploring and determining the vision of the company in the form of a vision statement.

ii Developing a mission statement of the company that should include statement ofmethodology for achieving the objectives, purposes, and the philosophy of theorganization adequately reflected in the vision statement.

iiiDefining the company profile that includes the internal analysis of culture, strengths andcapabilities of an organization.
iv. Making external environmental analysis to identify factors as threats, opportunitiesetc.
v.Finding out ways by which a company profile can be matched with its environment tobe able to accomplish mission statement
viDeciding on the most desirable courses of actions for accomplishing the mission of anorganization
viiSelecting a set of long-term objectives and also the corresponding strategies to beadopted in line with vision statement.
ViiiEvolving short-term and annual objectives and defining the corresponding strategies thatwould be compatible with the mission and vision statement.
IxImplementing the chosen strategies in a planned way based on budgets and allocation ofresource, outlining the action programs and tasks.
x.Installation of a continuous comparable review system to create a controlling mechanismand also generate data for selecting future course of action.

## 4.0 CONCLUSION

Chandler(1962)Strategy is the determinator of the basic long-term goals of an enterprise, and the adoption of courses of action and the allocation of resources necessary for carrying out these goals;Mintzberg (1979) Strategy is a mediating force between the organization and its environment: consistent patterns in streams of organizational decisions to deal with the environment.
Prahlad (1993) Strategy is more than just fit and allocation of resources. It is stretch and averaging of resources.
Porter (1996) Strategy is about being different. It means deliberately choosing a different set of activities to deliver a unique mix of value.
Mintzberg has identified the 5 P's of strategy. Strategy could be a plan, a pattern, a position, aploy, or a perspective.

## 5.0 SUMMARY

In this unit you learnt:
meaning of Corporate strategies, Types of strategies,Reasons and benefits of Corporate Strategy, Strategic Approach
We shall proceed to consider Product , Product mix and New Product development in the subsequent unit.

## 6.0 TUTOR-MARKED ASSIGNMENT

a) Discuss the process of developing and implementing a corporate strategy.

b) List and discuss the approaches to crafting a strategy.

c) What is strategy?

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# UNIT 6FORMS OF STRATEGY: GENERAL, CORPORATE & COMPETITIVE

## CONTENTS

1.0 Introduction
2.0 Objectives
3.0 Main Content
3.1The Concept of Strategy
3.2 Corporate Versus Competitive Strategy
3.3 FactorsAffecting Competitive Industry
4.0 Conclusion
5.0 Summary
6.0 Tutor-Marked Assignment
7.0 References/Further Readings

## 1.0 INTRODUCTION

This unit examines three forms of strategy based on the different ways in which the term is used in the business world:
(1) Strategy in a general sense;
(2) Corporate strategy; and
(3) Competitive strategy.

## 2.0 OBJECTIVES

At the end of this unit, students are expected to understand:

- Concept of strategy
- Analyse forms of strategy
- Discuss fundamental questions related to strategies.

## 3.0MAIN CONTENT

Keep one ear open in almost any business environment and the term "strategy" is sure to crop up on a regular basis. Unfortunately, those using the term frequently fail to define the way in which they are using it. Nor do those hearing it bother to check to see how it is being used. As a result, conversations about strategy can become confusing.
There are at least three basic forms of strategy in the business world and it helps to keep them straight. The objectives of this brief paper are to clarify the general concept of strategy and draw attention to the importance of distinguishing among three forms of strategy:
(1) General strategy (or just plain strategy)
(2) Corporate strategy and
(3) Competitive strategy

## 3.1THE CONCEPT OF STRATEGY

The many definitions of strategy found in the management literature fall into one of

four categories: plan, pattern, position, and perspective. According to these views, strategy is: A plan, a "how," a means of getting from here to there.

i) A pattern in actions over time; for example, a company that regularly markets very expensive products is using a "high end" strategy.
ii) A position, that is, it reflects decisions to offer particular products or services in particular markets.
iii) A perspective, that is, a vision and direction, a view of what the company or organization is to become.

As a practical matter, strategy evolves over time as intentions accommodate reality. Thus, one starts with a given perspective, concludes that it calls for a certain position, and sets about achieving it by way of a carefully crafted plan. Over time, things change. A pattern of decisions and actions marks movement from starting point to goal. This pattern of decisions and actions is called "realized" or "emergent" strategy.

## STRATEGY IN GENERAL

Strategy, in general, refers to *how* a given objective will be achieved. Consequently, strategy in general is concerned with the relationships between ends and means, that is, between the results we seek and the resources at our disposal. Strategy and tactics are both concerned with formulating and then carrying out courses of action intended to attain particular objectives.

Although it is not my aim to draw definitive distinctions between strategy and tactics, it is next to impossible to say something about one without also saying something about the other. Below is a summaryof some of the important differences between strategy and tactics.

| **Strategy** | **Tactics** | |
|---|---|---|
| **Scale of Objective** | Grand | Limited |
| **Scope of Action** | Broad and general | Narrowly focused |
| **Guidance Provided** | General and ongoing | Specific and situational |
| **Degreeof Flexibility** | Adaptable but not hastily changed | Fluid, quick to adjust and adapt in minor or major ways |
| **Timing** | Before action | During action |

| **Resource Focus** | Deployment | Employment |
|---|---|---|

Strategy and tactics are both terms that come to us from the military. Their use in business
and other civilian enterprises has required little adaptation as far as strategy in general is concerned; however, corporate strategy and competitive strategy do represent significant departures from the military meaning of strategy.

### 3.2 Corporate versus competitive strategy

Corporate strategy defines the markets and the businesses in which a company will operate. Competitive or business strategy defines for a given business the basis on which it will compete. Corporate strategy is typically decided in the context of defining the company's mission and vision, that is, saying what the company does, why it exists, and what it is intended to become. Competitive strategy hinges on a company's capabilities, strengths, and weaknesses in relation to market characteristics and the corresponding capabilities, strengths, and weaknesses of its competitors.

### 3.3 Factors Affecting Competitive Industry

According to Michael Porter, a Harvard Business School professor and the reigning guru of competitive strategy, competition within an industry is driven by five basic factors:

1. Threat of new entrants.

2. Threat of substitute products or services.

3. Bargaining power of suppliers.

4. Bargaining power of buyers.

5. Rivalry among existing firms.

Porter also indicates that, in response to these five factors, competitive strategy can take one of three generic forms: (1) focus, (2) differentiation, and (3) cost leadership.

Other factors affecting Corporate and Competitive strategy

Other writers on the subject of strategy point to several factors that can serve as the basis for formulating corporate and competitive strategy. Regardless of the definition of strategy, or the many factors affecting the choice of corporate or competitive strategy, there are some fundamental questions to be asked and answered. These include the following:

**Related to mission and vision**

- Who are we?
- What do we do?
- Why are we here?
- What kind of company are we?
- What kind of company do we want to become?
- What kind of company must we become?

**Related to strategy in general**

- What is our objective? What are the ends we seek?
- What is our current strategy, implicit or explicit?
- What courses of action might lead to the ends we seek?
- What are the means at our disposal?
- How are our actions restrained and constrained by the means at our disposal?
- What risks are involved and which ones are serious enough that we should plan for them?

**Related to corporate strategy**

- What is the current strategy, implicit or explicit?
- What assumptions have to hold for the current strategy to be viable?
- What is happening in the larger, social, political, technical and financial environments?
- What are our growth, size, and profitability goals?
- In which markets will we compete?
- In which businesses?
- In which geographic areas?

**Related to competitive strategy**

- What is the current strategy, implicit or explicit?
- What assumptions have to hold for the current strategy to be viable?
- What is happening in the industry, with our competitors, and in general?
- What are our growth, size, and profitability goals?
- What products and services will we offer?

- To what customers or users?
- How will the selling/buying decisions be made?
- How will we distribute our products and services?
- What technologies will we employ?
- What capabilities and capacities will we require?
- Which ones are core?
- What will we make, what will we buy, and what will we acquire through alliance?
- What are our options?
- On what basis will we compete?

## 4.0 CONCLUSION

In conclusion, strategy is concerned with deploying the resources at your disposal whereas tactics is concerned with employing them. Together, strategy and tactics bridge the gap between ends and means.

## 5.0 SUMMARY

The preceding discussion asserts that strategy in general is concerned with *how* particular objectives are achieved, with courses of action. Corporate strategy is concerned with choices and commitments regarding markets, business and the very nature of the company itself. Competitive strategy is concerned with competitors and the basis of competition.

## 6.0 TUTOR-MARKED ASSIGNMENT

a) Discuss the Factors Affecting Competitive Industry.

b) Write all you understand by corporate versus competitive strategy.

c) List 3 questions related to General, Corporate and Competitive strategy?

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## UNIT 7 BANKING SECTOR CONSOLIDATION

### CONTENTS

1.0 Introduction
2.0 Objectives
3.0 Main Contents
3.1 Overview of the Banking sector in Nigeria
3.2 The current banking sector reform
3.3 The future of emerging banks
4.0 Conclusion
5.0 Summary

6.0 Tutor Marked Assignment
7.0 References/Further Readings

## 1.0 INTRODUCTION

Banking sector consolidation has been an ongoing phenomenon that has been intensified due to the forces of globalization which are guiding the regulation of the world's financial markets and economies. Consolidation simply means the reduction in the number of banks and other deposit taking institutions with a simultaneous increase in size and concentration of consolidated entities in the sector.

## 2.0 OBJECTIVES

At the end of this unit, students are expected to understand:

- The Current Banking Sector Reform
- The future of Emerging Banks
- Nature of banking sector in Nigeria.

## 3.0 MAIN CONTENTS

### 3.1 Overview of the Banking sector in Nigeria

Modern form of banking in Nigeria started in 1892 when the African banking Corporation (ABC) commenced formal banking business. ABC was later taken by the Bank of British West Africa which metamorphosed to the present day First Bank of Nigeria Plc. Between 1927 – 1951 there were 25 indigenous Banks out of which 23 failed leaving only 2. The failure was due to the absence of banking regulation, inadequate capital, shortage of qualified personnel and other factors. The banking ordinance of 12952 was then enacted to regulate the banking environment. Subsequent efforts at strengthening the regulatory framework resulted in the enactment of the CBN act 1958, the NDIC act 1988, the CBN act 1991, and the banks and other financial institutions act of 1991. Nigerian banks were however characterized by large number of small banks with few branches, poor rating of a number of banks (as at December 2004, out of 89 banks no bank was rated very sound, only 10 were rated as sound, 51 were rated satisfactory, 16 were rated marginal and 10 unsound). The sector was also characterized by weak corporate governance, negative capital adequacy ratio, over dependence on public sector deposits and eroded shareholders' funds caused by operating losses.

### 3.2 The Current Banking Sector Reform

Since Nigerian Banking sector is characterized by problems, then there is the need to restructure the system. Restructuring becomes necessary so as to create a strong and reliable banking sector which will play active developmental roles in the Nigerian economy and the world financial system at large.
On July 6, 2004 the CBN governor enunciated the thrust of the banking system reform program in his 13 point reform agenda. Two major elements of the reform agenda are the requirement of the Nigerian banks to increase their share holders' funds to a minimum of N25 billion by the end of December 2005, and consolidation through mergers and acquisition.

The objectives of the reform are as follows;

1. Minimum capitalization of N25 billion before end of December 2005.
2. Phased withdrawal of public sector funds from banks
3. Consolidation through mergers and acquisition
4. Adoption of risk focused and rule based regulatory framework
5. Adoption of zero tolerance in the regulatory framework.
6. The automation process for rendition of returns by banks through the electronic and financial analysis surveillance system (e - FASS)
7. Establishment of hotline confidential internet address (governor @ cenbank.org) for Nigerians wishing to share any confidential information with the CBN governor on banking operations.
8. Strict enforcement of the contingency planning framework for systematic banking distress
9. Establishment of an assets management company as an important element of distress resolution.
10. Promotion of the enforcement of dormant laws especially those relating to the issuance of dud cheques and the law relating to the vicarious liability of the board of banks in cases of failing by the banks.
11. Revision and updating of the relevant laws and drafting of new ones on banking operation
12. Closer collaboration with the economic and financial crimes commission (EFCC) in the establishment of the financial intelligence unit and enforcement of anti-money laundering and other economic measures.
13. Rehabilitation and effective management of the mint to meet the security printing needs of Nigeria.

### 3.3 The future of Emerging Banks

Banks in Nigeria have faced a lot of challenges which includes inadequate experience and technical knowledge on large scale consolidation, huge cost associated with consolidation, problems of nonperforming loans, operational

challenges arising from information communication technologies (ICT) system and supervision / regulation of mega banks.
One of the main effects of consolidation in Nigeria is the reduction in the number of banks in the system. But the emerging ones are better capitalized and bigger, this is because the minimum N25 BILLION induces growth.
The mega banks that have also emerged may have stronger capacity to take big risks and thus be better able to finance key growth sectors of the economy.
The weak banks are also out of the industry in an orderly manner, while some have merged together, others have been acquired by bigger banks and those that have no suitors have been forced into a "marriage of convenience"
Good corporate governance is also a feature of the emerging banks; since the shareholding base of the banks' is increased thus, family owned banks are eliminated.
Merger and acquisition that resulted due to consolidation will improve the profitability of the emerging banks as well as operational efficiency.
One of the negative effects of the reform is the retrenchment of workers in the banking industry; this is more pronounced in the weak banks that are acquired by strong ones.

## 4.0 CONCLUSION

Banks consolidation brought about a lot of benefits to the stake holders in the industry. The current banking sector reform if well implemented will cleanse the industry so that a stricter and more professional supervision and regulation could be achieved. The Central Bank of Nigeria should however need the cooperation and support of the stake holders for a successful implementation of the reform.

## 5.0 SUMMARY

Banks consolidation is motivated by technological innovations, deregulation of financial services, enhancing intermediation, increased emphasis on shareholder value as well as privatization and international competition (Berger and etal1999, IMF 2001). Capitalization is an important term that is achieved through consolidation this is so due to the fact that a bank with a strong capital base has the ability to absolve losses from non performing liabilities (NPL).

## 6.0 TUTOR-MARKED ASSIGNMENT

1) Summarize the objectives of Banking reform in Nigeria.
2) Discuss the Overview of the Banking sector in Nigeria.

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## UNIT 8CONSOLIDATION IN THE OIL AND GAS INDUSTRY THROUGH MERGERS AND ACQUISITIONS

**CONTENTS**

1.0 Introduction
2.0Objectives
3.0 Main Contents
3.1Regulatory Framework
3.2 Merger procedures
3.3 Acquisitions
3.4 Takeover
3.5 Disclosure of negotiations
3.6 Sanctions
4.0 Conclusion
5.0 Summary
6.0 Tutor-Marked Assignment
7.0 References/Further Readings

### 1.0 INTRODUCTION

The oil price recently fell as low as $46 a barrel having hovered between $50-$60 per barrel since the beginning of year 2016. It may yet fall further given the crisis rocking China's capital market or could rebound starting a welcome recovery. The current low prices is putting tremendous strain on the cash flow of all oil companies irrespective of size begging them to ask serious questions of

themselves as to their survival in the near and/or long term. Some of these questions include but are not limited to:
a) The length of time it would take for oil prices to begin to rise from their current slump.
b) The necessary cuts required in adapting to this new low price environment.
c) Is the industry likely to witness a wave of mergers and acquisitions to both scale and capture growth positions at the current low prices or will the focus be more on high margin lower risk assets to strengthen cash flow.

## 2.0 OBJECTIVES

At the end of this unit, students are expected to understand:

- Acquisitions
- Legal framework for mergers and acquisitions in Nigeria.
- Documentation for required business combinations transactions

## 3.0 MAIN CONTENTS

The International Oil Companies (IOC) operating in Nigeria and Nigerian independents are not immune from the vagaries of the global oil market. Their fortunes are made worse by a number of factors including but not limited to the non-passage of the Petroleum Industry Bill (PIB) and the inability of NNPC to meet its cash call obligation under its various joint ventures. It is perhaps in anticipation of these present circumstances that IOC's such as Shell and Chevron, as far back as 2010, commenced divesting assets they may have deemed as higher cost assets with Nigerian independents snapping them up in the hope of having a firmer foothold in upstream activities.
What may have been seen as a good opportunity for Nigerian independents may up until last year be turning out to be a nightmare for some of these companies. The low oil price is beginning to affect their balance sheets with some struggling to meet their debt obligations. Perhaps, and as a means of survival, we may begin to see mergers and acquisitions as a crucial part of the solution for both the IOCs and Nigerian independents operating in the oil and gas sector in Nigeria. On the international scene and from an IOC perspective, we have already seen Royal Dutch Shell leading the way with its proposed $55 billion takeover of BG. If the current decline in oil prices continues on a scale compared to that of 1998/99 we may see another wave of mega mergers akin to that of the super majors like Exxonmobil and TotalElfFina. On the domestic front, plunging oil prices has forced Afren, a UK company with a subsidiary in Nigeria, into administration with the Nigerian assets in its portfolio up for sale. Mid- Western Oil and Gas Limited also recently pulled out of the proposed acquisition of Mart Resources perhaps to ensure it accesses Mart's Nigerian assets at a lower cost.

With debt pressures mounting on the recent purchasers of the IOC divested assets, it seems inevitable that a new wave of industry consolidation will soon commence. In light of the foregoing and the impending flurry of consolidation activities in the sector, it is important that stakeholders understand the legal framework for mergers and acquisitions in Nigeria.

**3.1 Regulatory Framework**

The principal Legislations and Regulations governing Mergers, Acquisitions and Takeovers ("M&A") in Nigeria are the Investment and Securities Act, 2007 ("ISA"); the Companies and Allied Matters Act ("CAMA") LFN 2004 and the Securities and Exchange Commission Rules and Regulations, 2013 ("SEC Rules"). In addition to these, there are sector specific Legislations and Regulations relating to M&A such as the Petroleum Act Cap P10, LFN 20041; Central Bank of Nigeria Act, 2007 and the Banks and Other Financial Institutions Act, Cap B3, Laws of the Federation of Nigeria, 2004 regulating M&A in the banking and financial sectors2; the Electricity Power Sector Reform Act 2005 regulating the nascent electricity sector in Nigeria3; The Insurance Act, 20034; the Companies Income Tax Act5 and the Nigerian Communication Act No 19 Cap N97 LFN 2004 regulates M&A in the telecommunications sector.
The Securities and Exchange Commission ("SEC") , by virtue of the ISA, exercises regulatory oversight over all forms of business combinations between or among all private companies, all public companies, partnerships and transactions consummated under the authority of any Federal or State Government Agencies.
However, holding companies acquiring shares solely for the purpose of investment without intent to use the acquired shares for voting or causing a substantial restraint of competition or create a monopoly are exempted from the application of the ISA7. This exemption is somewhat vague and may lend to interpretational issues. Firstly, the section is silent on who determines whether the transaction is solely for investment purpose- the merging parties or SEC as regulator? Secondly, one is hardly able to exclude the possibility that parties may consummate an acquisition that can restrain competition but present the transaction as being solely for investment purposes. It is hoped that this lacuna would be addressed in a subsequent review of the Act.

**3.2 Merger procedures**

The ISA8 and the SEC9 Rules classifies Mergers into three broad categories: Small, Large and Intermediate. In determining whether a merger or proposed merger is small, large or intermediate, SEC periodically prescribes a lower and upper threshold of mergers. The extant SEC Rules provides that, to qualify as a small merger, either the combined assets or turnover of the merging companies must be below N1,000,000,000.00 (One Billion Naira). The threshold for an

intermediate merger is between N1,000,000,000.00 (One Billion Naira) and N5,000,000,000.00 (Five Billion Naira) whilst the threshold for a large merger is any value above N5,000,000,000.00 (Five Billion Naira).

**1. Small Merger**

The parties to a small merger do not require the approval of SEC before the commencement of the merger procedure. However, SEC reserves the right to, within six months from the commencement of the small merger process, request formal notification from the parties where SEC is of the opinion that the proposed mergers may substantially prevent or lessen competition and/or such merger cannot bejustified on the grounds of public interest. The parties may elect to voluntarily notify SEC at any time during the merger process and are required, upon successful completion to notify SEC of the completion.

The Procedure for small mergers is set out in Section 12214 as follows:

a. Parties notify SEC (if required to). Where parties are required to notify SEC, they cannot proceed until SEC's approval or conditional approval is obtained.

b. Where the parties are required to notify SEC and after they, the parties, have fulfilled their notification requirement, SEC may within 20 working days notify the parties in the prescribed manner of its:

i. approval of the merger;
ii. approval of the merger subject to any conditions;
iii. prohibition of the merger , if it has not been implemented; and
iv. if already implemented, a declaration that the merger is prohibited.

c. SEC may extend the period within which to consider the merger by a single period, not exceeding forty (40) working days in which case it must issue an extension certificate to the parties. Upon the expiration of the twenty (20) working days or the expiration of the extension, if SEC has not notified the parties of its decision, the merger shall be deemed to have been approved.

d. SEC shall publish a notice of its decision in the Gazette and issue written reasons for its decision if it (a) prohibits or conditionally approves the merger (b) is requested to do so by a party to the merger.

e. Where the merger is approved the parties shall apply to the Federal High Court ("FHC") to sanction the merger and once this is done it becomes binding on the parties.

## 2. Intermediate and Large Mergers

The parties to an intermediate or large merger are obligated before commencement to notify SEC of the proposed merger and obtain prior approval, with or without conditions. The procedures for intermediate and large mergers are set out in Sections 123-126 of the ISA and they are as follows:
a. The parties, the primary acquiring company and the primary target company, shall each send pre-merger notices to SEC in the prescribed form. A copy of the said notice is to be sent to any registered trade union that represents a significant amount of the employees or any employees or representatives concerned where there is no such trade union.

b. As part of its oversight functions, SEC may investigate or assign an inspector(s) to investigate the proposed merger and may require that any of the parties provide additional information.

c. In respect of intermediate mergers, SEC is to within 20 working days after all notification requirements have been met by the parties, issue a certificate either (a) approving the merger (b) approving the merger subject to some conditions or (c) prohibiting the implementation of the merger. As with small mergers, SEC may extend the period within which to consider the merger, provided that it issues an extension certificate to the parties and upon the expiration of the 20 days or the extended period, if it fails to issue a certificate, the merger is be deemed to have been approved.

d. SEC is to publish a notice of its decision in the Gazette and issue written reasons for its decision if it (a) prohibits or conditionally approves the merger (b) is requested to do so by a party to the merger.

e. For large mergers, SEC is required to refer the notice filed by the parties to the FHC and within forty (40) working days after the parties have fulfilled the prescribed notification requirements, forward to the court a statement in writing stating whether the merger was approved, approved subject to conditions or prohibited.

The merger notice to SEC is typically accompanied with the following documents:

(a) Completed Merger Notification Form
(b) A joint letter of intent from the merging entities
(c) Extract of Board Resolutions of the merging entities in support of the merger duly certified by a Director and the Company Secretary.
(d) A copy of the letter appointing the financial adviser(s),

(e) Certificate of Incorporation certified by the Company Secretary, certified true copies of Form CAC 7, and Memorandum and Articles of Association of the merging entities. (f) A letter of No objection from the Companies Regulator(s) (where applicable) (g) The Audited Account of the merging entities for the preceding five (5) years or the number of years the Companies have been in operation, if less than five (5) years. (h) Evidence of payment of the prescribed filing fee and (i) Information Memorandum.

It is instructive to note that the Act gives SEC the powers to revoke its decision to approve a small, intermediate or large merger if it is discovered that any of the parties provided incorrect information or an approval was obtained by deceit or a breach of an obligation attached to the merger by any of the merging parties.
The Scheme Document
This is the principal document in a merger transaction which contains corporate and other information about the merging entities. Typically the scheme document would, amongst other things, provide the following information:

1. Separate letters from the Chairmen of the merging companies addressed to their respective shareholders.
2. Explanatory statement to the shareholders by the joint financial advisers, addressing the following:

a) The proposal.
b) Conditions precedent.
c) Reasons for the proposal.
d) The synergies/ benefits.
e) Plan for employees.
f) Capital gain tax.
g) Approved status.
h) Meetings and voting rights.
i) Instruction on proxies.
j) Settlement and certificate
k) Information regarding each of the merging companies.
l) Recommendations
m) Appendices.

### 3.3 Acquisitions

The SEC regulates acquisitions for both private and public unquoted companies. The procedure for an acquisition involves the acquirer filing a letter of intent through a registered capital market operator. The letter of intent is to be accompanied by the following documents:

1) Two (2) draft copies of Information Memorandum;

2) Extracts of board resolutions of the acquirer and the acquiree agreeing to the acquisition signed by the company's secretary and a director. (*Where applicable*);
3) The recent CAC certified true copy of the Memorandum and Article of Association of the acquirer and the acquiree;
4) The certificate of incorporation of the acquirer and the acquire, certified by the company secretary;
5) Extracts of shareholders resolution of the acquirer and the acquiree to be signed by a director and company secretary;
6) Summary of the claims and litigations of the company to acquired;
7) A copy of "No Objection" letter from the relevant regulatory body (*where applicable*);
8) Copies of letters appointing the financial advertiser(s);
9) CAC certified form showing particulars of directors and allotment of shares of the acquirer and the acquiree;
10) Notarized consent of directors of the acquirer and the acquire;

11) Financial services agreement between the acquirer and the acquiree and their respective Financial Advisers;
12) Share purchase agreement and any other relevant agreement executed between the acquirer and the acquiree;
13) Evidence of payment of prescribed fees;
14) Annual report and accounts of both companies for the proceeding period of five (5) years or a shorter period of three (3) years for private companies and those that have been operating for less than five (5) years;
15) Source of fund to finance the acquisition must be clearly disclosed and supported by documentary evidence; and
16) Report of valuation shares/assets (*where applicable*).
The SEC Rules also makes provision for the publication of the acquisition in two national newspapers.
With respect to dissenting shareholders, Rule 438 of the SEC rules stipulates that dissenting shareholders are to be treated as contained in Sections 146 &147 of the ISA 2007. However the recent amendment to the SEC Rules is silent as to whether the provision empowering the dissenting shareholders to lodge a complaint to SEC will apply in the case of an acquisition.

### 3.4 Takeover

The quantity/value of shares that is considered sufficient to confer control is usually fixed by law. By virtue of section 131(1) ISA, acquisition of between 30 and 50 %( or a lower or higher threshold as may be prescribed by SEC from time and to time) of the rights of the target company's called up shares by individual or company qualifies as a takeover.

A takeover bid is dispatched to shareholders of the target company in order to acquire shares of any class, attain sufficient shares so that the target becomes subsidiary or gains control over the company. By virtue of section 133 (4), a takeover bid cannot be made for a private limited liability company. Further, a bidder is required by virtue of Rule 445 (4) SEC Rules 2013 to publish its takeover bid in at least 2 (two) national daily newspapers. This is to serve as a notification to the general public of its intention to offer a takeover bid for the target company. In addition this, SEC rules also mandates a bidder to make an announcement on the floor of the stock exchange of their intention to make a takeover bid to the target company.

### 3.4.1 Procedures for Takeover:

**1. Due Diligence**

After a company identifies its target, it appoints professional advisers ranging from lawyers, to accountants, environmental consultants, pension advisers to carry out thorough investigations on the target. Due diligence is carried out to provide an accurate reflection of the company's status. The target may also want to be prudent and carry out due diligence on the bidder. It is advisable that the bidder also carries out thorough investigations of the operations and debt exposure of the target, thereby diminishing chances of future liability due to errors in representations and warranties

**2. Shareholders discussions**

The bidding company shall ascertain its bidding price and set out to make provisions for the necessary finances in implementing the bid. Shareholder with majority holdings may initially have an informal discussion on the takeover bid before a board meeting is scheduled where the formal resolution will be made to set the bid in motion.

**3. Authority to Proceed**

By virtue of the provisions of the ISA and the SEC Rules, a takeover bid cannot be made until SEC has given its authority to proceed. The bidding company makes an application to SEC providing documentation and reports in a prescribed form by the Regulations. Where SEC requires further information from the bidder, it would make a request for the additional information and subject to the conditions in sub section 6, SEC may grant its authority to proceed.

The authority to proceed with a bid granted by SEC is for a period of three months subject to renewal upon application by the person making the bid. Such application for renewal is required to be made at least fourteen (14) days before the expiration of the three months and the renewal shall be for a period of three months.

**4. Registration of bid with SEC**

A copy of the takeover bid is required to be lodged with SEC for registration before it is dispatched to the shareholders of the target company. SEC will register the bid once it is satisfied with compliance with the ISA and SEC Rules, otherwise it may refuse registration of the bid and notify the applicant accordingly. Within thirty (30) working days of such notice of refusal, the company can appeal to the Investments & Securities Tribunal ("the Tribunal") for a review of SEC's decision. 22 Section.

**5. Dispatch of bid**

The bidding company would thereafter dispatch the takeover bid to each shareholder of the target company as well as SEC, at least 7 days before the date on which the takeover bid is to take effect. Each shareholder is entitled to accept or reject the bid. Upon receipt of the takeover bid, the directors of the target company are required to issue a directors' circular to all shareholders of the company. The amendment to the SEC rules provides that such circular must state interalia, the particulars of the bidder; the number of shares sought to be acquired; the effect of the takeover bid on the company's operations and its employees; and the directors' opinions and recommendations on the takeover bid. This amendment seeks to ensure that the directors of the target company proffer their opinion and recommendations to shareholders on the likely effect of the takeover to the company.
Where majority shareholders, holding no less than 90% of the shares subject to be acquired, have accepted the bid the ISA provides that the acquiring company may within one month after the date of the acceptance of the shares, give notice to the dissenting shareholders that the takeover bid has been accepted, it would or have paid off those who accepted the bid, and that the dissenting shareholder has to elect whether to be paid the way the other shareholders were paid or prefers that his shares to be valued and a fair value paid to him. However, with the recent amendments to SEC Rules the dissenting and aggrieved shareholders can now lodge a complaint with SEC.25

**6. Announcement of bid**

The acquiring company may now proceed with announcing the bid and commence implementing marketing campaigns. There may be need for adjustment of the bid due to the reactions of the target and market. The acquiring company may proceed with payment of considerations when the acceptance is received within the prescribed period. With a successful bid, all post bid requirements will be fulfilled as well as resolutions on the issues with dissentients.

**Documentation Required for Business Combination Transactions**

a) Separate extract of board resolutions of the merging companies in support of the merger duly certified by a director and the company secretary.
b) Copy of letters notifying the trade union of the relevant industry of the intention of the companies to merge (required for mergers).
c) A copy of the letter appointing financial advisers.
d) Certificate of incorporation certified by the company secretary.
e) Certified True Copies of Form CAC 7, CAC 2. (required for private companies)
f) Memorandum and articles of association of the merging companies.
g) A letter of "No Objection" from the Companies' Regulator(s). (where applicable)
h) The audited accounts of the merging entities for the preceding five years or the number of years the companies have been in operation if not up to five years.
i) Evidence of payment of filing fees.
j) Draft financial services agreement between the merging entities and their financial advisers.
k) Evidence of increase in authorized share capital. (where necessary)
l) Signed and notarized consent letters of directors and parties to the merger.
m) Copy of merger implementation agreement and other agreements executed by the merging entities.
n) Draft proxy forms for each of the merging companies.
o) A letter of undertaking to file evidence of settlement of all tax liabilities of the Federal Inland Revenue Services (FIRS).
p) Certificate of capital importation (where applicable).
q) Reporting Accountant's report on the financials and forecast of the merging entities.
r) List of claims and litigation of the merging entities.
s) Scheme Document/Information Memorandum/ Takeover Bid.

**Pre-Contract Issues**

There are several pre-contract issues that parties to a proposed merger have to consider prior to the merger process. It is typical for the parties to enter into several pre-merger agreements such as Exclusivity Agreements26, Memorandum of Understanding27 ("MOU") and Confidentiality Agreements28. These

Agreements are aimed at regulating the relationships of the merging parties prior to conclusion of the merger process.
In addition to the pre-merger agreements, the parties would conduct due diligence on each other to ascertain that the assertions forming the basis of the proposed merger are indeed accurate. Broadly speaking, the due diligence process covers legal and financial issues pertaining to both companies.
The legal due diligence is to ascertain that the company is legally incorporated and is a going concern; that all required business permits and certification have been validly procured; that resolutions of board of directors, general meetings were validly made in consonance with the company's memorandum and articles; compliance and regulatory issues, material claims against the companies, intellectual property, labour and employees issues.
Financial due diligence would typically seek to cover the parties' accounts and monetary control systems; past and present financial performance compared against budgets; the parties' viability in the short term and long term, against industry indicators; tax liabilities and other tax related implications as a result of the proposed deal; value of the assets and liabilities of the parties; product portfolio and competitors; performance ratios- profitability and earnings ratios, capital investments etc.; evaluation of synergy. ; a thorough credit check to ascertain the true financial position of the parties' in meeting their liabilities.

### 3.5 Disclosure of Negotiations

Disclosure requirements are only relative to public companies in Nigeria. SEC maintain that a takeover bid be publicized in at least two national newspapers. SEC rules also mandate a bidder to make an announcement on the floor of the stock exchange of their intention to make a takeover bid to the target company.
The ISA on the other hand do not precisely require disclosure of mergers and acquisition transactions.

### 3.6 Sanctions

The recent amendment to the SEC Rules provides for penalty for non-compliance with the provisions of section 118(1) of the ISA and Rule 423(1) with respect to seeking the approval of SEC prior to commencing any form of business combination in Nigeria. 29
In the case of a merger amongst companies with combined assets or turnover between N1,000,000,000.00 and N5,000,000,000.00, contravention of section 118(1) of the ISA and Rule 423(1) attracts a penalty of not less than N1,500,000.00 and thereafter N5,000.00 for every day of continuing default or nullification of the said transaction from the date of consummation of the transaction.

Mergers amongst companies with combined assets or turnover of N5,000,000,000.00 and above shall be liable to a penalty of not less than N2,000,000.00 and thereafter N5,000.00 for every day of continuing default or nullification of the said transaction from the date of consummation of the transaction .
An acquisition in a private/ unlisted public companies with combined assets or turnover of N500,000,000.00 and above shall be liable to a penalty of not less than N1,000,000.00 and thereafter N5,000.00 for every day of continuing default or nullification of the said transaction from the date of consummation of the transaction.

## 4.0 CONCLUSION

The laws regulating mergers in Nigeria are extensive and as such parties contemplating transactions of this nature must ensure that the procedure followed is in compliance with the laws to avoid any sanctions.

## 5.0 SUMMARY

In this unit you learnt:

- Merger procedures for Small, Large and Intermediate.
- Documentation for required business combinations transactions
- Acquisitions
- Disclosure of negotiations

## 6.0 TUTOR-MARKED ASSIGNMENT

1) Highlights the content of documentation required for business combinations transactions
2) What is the Procedure for small mergers?
3) Discuss the Procedure for Takeover.

## 7.0 REFERENCES/FURTHER READINGS

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*Selected writings, 1927-1939* (translated by A. Stoekl). Minneapolis: University of MinnesotaPress.

## UNIT9INCENTIVESON CONSOLIDATION INTHENIGERIAN BANKING INDUSTRY

## CONTENTS

1.0 Introduction
2.0 Objectives
3.0 Main Contents
3.1 Definition of key terms
3.2 Consolidation Option
3.3 Incentives
3.4 Forbearance
3.5 Legal Issues
3.6 Accounting Issues
3.7 Corporate Governance
3.8 Social Safety Net
3.9 Amnesty for past Misreporting
4.0 Conclusion
5.0 Summary

6.0 Tutor-marked Assignment
7.0 References/Further Readings

## 1.0 INTRODUCTION

Following the Governor's address to the Bankers' Committee on July 6,2004, on the Nigerian banking sector reform and the subsequent interactions with various stakeholders, the Board of the Central Bank ofNigeria has approved the guidelines and incentives to facilitate consolidation in the industry in order to assist banks in meeting theapproved capital base of N25 billion by December 2005.

## 2.0 OBJECTIVES

At the end of this unit, students are expected to understand:

- Consolidation option
- Legal framework for Banks consolidation in Nigeria.
- Corporate governance on Consolidation policy

## 3.0 MAIN CONTENT

### 3.1 DEFINITION OF KEY TERMS

For the purpose of the guidelines, the following definitions shall apply:
**Capital base:** paid-up capital and reserves unimpaired by losses.
**Reserves:** all reserves except asset revaluation surplus resulting from revaluation in the course of consolidation.
**Paid-up capital:** ordinary shares plus non-redeemable preference
shares

**Parties to the Consolidation:** the banks that are merging, their boardsand managements, financial/investment advisers,lawyers, accountants, auditors, shareholders andany other persons involved in the transaction.

### 3.2 CONSOLIDATION OPTION

The only legal modes of consolidation allowed are mergers and outright acquisition/takeover. A mere group arrangement is not acceptable forthe purpose of meeting the N25 billion. Therefore, all banks that haveother banks as subsidiaries or have common ownership are encouragedto merge.

### 3.3 INCENTIVES

The CBN intends to provide the following incentives for banks that

consolidate and/or are able to achieve the set minimum capital basewithin the stipulated period:
1.Authorisation to deal in foreign exchange
2. Permission to take public sector deposits and recommendation tothe fiscal authorities for the collection of public sector revenue.
3. Prospects of managing part of Nigeria's external reserves, subject to prevailing guidelines. In order to ensure that banking institutions do not bear additional burdendue to consolidation which they otherwise would have not borne, andalso to encourage consolidation, the following additional incentives arebeing worked out:
4. Tax incentives in the areas of capital allowances, company incometax, stamp duties, among others, the details of which will be released after the on-going consultation with the fiscal authorities.
5. Reduction in transaction costs, the details of which will be releasedafter the on-going consultations with the Securities and ExchangeCommission, Nigerian Stock Exchange, Corporate Affairs Commission and all other parties involved in the scheme –
- Financial Advisers
- Solicitors to the scheme
- Stockbrokers to the scheme (where applicable)
- Reporting Accountants to the scheme
- Auditors to the scheme
6. The CBN will provide and pay for a team of experts to provide technical assistance to
the banks from August 15, 2004.
7. There will be the CBN Governor's distinguished industry leadershipaward which would be based on the following:
i.Speed of completion of the consolidation exercise
ii. Successful acquisition of marginal and unsound banks; and
iii.The number of banks involved in each consolidated group
8. The CBN will provide a help desk to fast-track approvals.

**3.4 FOREBEARANCE**

1. The CBN will negotiate the possible write-down of its exposure to the distressed banks that would be acquired as a way of improving their balance sheets as well as the treatment of the distressed banks' bad assets. The negotiation will also address the interests ofthe current owners of the distressed banks in the new arrangement.
2. The CBN will encourage and facilitate the setting up of an AssetManagement Company (AMC) in collaboration with other relevantagencies.

**3.5 LEGAL ISSUES**

1. The banks should comply with the legal requirements on mergers and acquisitions as contained in S.100 – 123 of the Investment andSecurities Act No. 45, 1999 and all other regulatory requirements.
2. The banks should obtain the approval of the Governor of theCentral Bank of Nigeria as required under S.7 of the Banks andOther Financial Institutions Act [BOFIA] as amended before anymerger and/or acquisition is consummated and/or announced.
3. The legal and regulatory requirements for effecting a consolidationwill be obtainable from the CBN Help Desk, team of experts, theSecurities and Exchange Commission (SEC) and the Nigeria StockExchange.
4. The CBN will actively collaborate with all agencies to fast-track theprocess of mergers and acquisitions

## 3.6 ACCOUNTING ISSUES

1. The valuation of the shares should be carried out by reputable andindependent advisers registered by SEC.
2. The valuation method should be agreed to by all the parties for thepurpose of determining the consideration.
3. The valuation principles must be consistently applied to all parties involved in the combination.
4. Any revaluation of fixed assets carried out in the case of a mergershould not be incorporated into the financial records of theconsolidated bank except as approved by the CBN.
5. Subject to 7.4 above, the revaluation of fixed assets carried outwhere one bank acquires the other bank should be incorporatedinto the financial statements as these assets would be acquired atfair market value
6. The valuation should be to the satisfaction of the CBN that such arevaluation represents the fair value of the assets acquired.
7.It is the responsibility of the parties to the transaction to ensure thatthey conduct due diligence of one another as a necessary step inthe consolidation process.
8. All the capital of whatever form, shall be denominated in Naira.
9. Both ordinary and preference shares shall be recognizedin making up the minimum capital base of N25 billion.
10.Consideration in respect of all mergers by banks should be byexchange of shares and not monetary payments except wheredissenting minority shareholders are to be bought out under thelaw, provided that any such payment does not impair the financialcondition of the surviving bank.

## 3.7 CORPORATE GOVERNANCE

1. All parties to the consolidation must have access to all material information.

2. Each party should have an independent adviser except where the acquired bank is a wholly owned subsidiary of the acquirer.
3.The structure of the emerging organisation should reflect defined lines of responsibility and hierarchy. Co-Chairman and/or Co-Chiefexecutive officer arrangements will not be allowed.
4.The number of non-executive directors in the enlarged bank should be more than the number of executive directors subject to amaximum board size of 20 directors.

## 3.8 SOCIAL SAFETY NET

1. The CBN and the NDIC will ensure that the banks protect theinterest of the depositors
2. To ameliorate the effect of possible job losses or redundancies, anystaff exiting as a result of the consolidation should be compensatedby the consolidated entity in line with industry standards, but notbelow the terms of their sustaining employment.
3. In addition, the CBN will work with the Bankers' Committee to assistthe staff that will be disengaged to access the SMIEIS Fund to set uptheir own SMEs and consequently create jobs and wealth.

## 3.9 AMNESTY FOR PAST MISREPORTING

1. Banks are enjoined to be open in their negotiations by placing the actual value of their assets on the table. Sanctions shall not beimposed for any previous misreporting detected in the course ofconsolidation.
2. However, if any of the parties to the consolidation is found, after the consolidation exercise, to have presented false or misleadinginformation to the other parties and/or the regulatory authorities,such a party will bear the full legal and regulatory consequences ofsuch misbehavior.

## 4.0. CONCLUSION

The consolidation guideline and incentives policy of CBN remains a vital point of advise
and regulation to the Banking Industry in order meet up with the capital base
requirements in the Industry. It is a modality of ensuring strong and competitive Banking
Industry in Nigeria.

## 5.0 SUMMARY

In this unit you learnt guidelines and incentives on consolidation in the Nigerian banking industry our attention focused on:

- Consolidation option
- Incentives
- Forbearance
- legal issues
- Accounting issues
- Corporate Governance
- Social safety net
- Amnesty for past misreporting

## 6.0 TUTOR-MARKED ASSIGNMENT

1) What are the incentives provided by the CBN on Banks consolidation to attain minimum capital.
2) What is social safety net?
3) Give detail analysis of accounting issues on consolidation.

## 7.0 REFERENCES/FURTHER READINGS

Needle, David (1999).*Business in Context.*London: Thomson BusinessPress.

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## UNIT 10: PRODUCTS

**CONTENTS**

1.0 Introduction
2.0 Objectives
3.0 Main Content
3.1 The Meaning of a Product
3.2 Product Levels
3.3 Elements of a Product
3.4 Product Classification
4.0 Conclusion
5.0 Summary
6.0 Tutor-Marked Assignment
7.0 References/Further Readings

### 1.0 INTRODUCTION

This unit introduces you to fundamental product concepts, beginning with a broad definition of "product". After this, we will see how marketers classify the products they deal with and, this is usually a vital step in designing your marketing strategy. The unit also takes you through the elements that make up a product.

### 2.0 OBJECTIVES

After studying this unit, you should be able to:

Define the term production.
Describe the various classifications of consumer and industrial products.
Explain the value of branding and discuss typical branding strategies.
Analyse the two primary functions of packaging.
Discuss the three primary functions of labeling.
Describe the important elements of product support.

## 3.0 MAIN CONTENT

### 3.1 THE MEANING OF A PRODUCT

Let us start by asking you to name any three "products" off head. You are most likely to consider things like cola, shoes, cars... or three other similar products. Indeed, you might not thing of games reserves, WEMA Treasure account, or the popular TV comedy - "Papa Ajasco". This is because when we are on the buying end of an exchange, we often think of products as tangible objects, that is, things we can actually touch and possess. Football teams, transport companies, TV programme etc. provide an intangible service for our use or enjoyment, not for our ownership.

Hence, from the marketing point of view, a product is defined as anything offered for sale for the purpose of satisfying a need or want on both sides of the exchange process. In this regard, a product includes a tangible object that marketers refer to as a good, as well as an intangible service (such as an ideas, a place, an event, an organization etc), or any combination of tangible objects and intangible services. Quite often, most products consist of a bundle of attributes that can be heavy on the tangible side, or heavy on the intangible side, or anywhere in between.

### 3.2 PRODUCT LEVELS

As illustrated by Figure 8.1, products can be viewed under five levels. Each of these levels adds more customer value, and the five constitute a customer value hierarchy. The most fundamental level is the core benefits i.e. the fundamental service or benefit that the customer is really buying. For instance, the core benefit enjoyed by a guest in a hotel is "rest and sleep".

At the second level, the marketer has to turn the core benefit into a basic product. In the hotel example, such things as a bed, bathroom, towels, table, chair, dresser and closet are the basic products enjoyed by a guest in the hotel. In the third level, the marketer prepares an expected product i.e. a set of attributes and conditions buyers normally expect when they purchase a product. For instance, hotel guests expect a clean bed, fresh towels, working lamps, and a relatively quiet environment.

At the fourth level, the marketer prepares an augmented product that exceeds customer expectations. In this wise, a hotel can include a remote-controlled TV.

Set, remote-controlled air conditioner, fresh flowers, rapid check-in, express checkout, and fine dining and room service. You need to understand that in the developed countries, however, competition takes place mostly at the expected product level.
At the fifth level, is the potential product, which consists of all the possible augmentations and transformations the product might undergo in the future.
The foregoing description of the different layers of a product should make it clear that a product is definitely more than a simple set of tangible features. Consumers actually want to see products as complex bundle of benefits that satisfy their needs. The facts, as of today are that most competition takes place at the product augmentation level. This is why successful firms add benefits to their offers. Such benefits not only satisfy the customers, they are also delighted.

## 3.3 ELEMENTS OF A PRODUCT

Elements that make up a product include attributes, branding, packaging, labeling, and product support services. Certain decisions along these lines are often made concerning the development and marketing of individual products. Each of these elements applies to all categories of products. However, the way marketers handle them can vary significantly from one product to another. Actually, one of the primary goals of marketers is to differentiate their product from competing ones by developing unique strategies for each product element. We shall be taking a closer look at each of these elements.

### 3.3.1 PRODUCT ATTRIBUTES

The development of a product necessarily involves the consideration of the benefits that the product will offer. Such benefits are communicated and delivered by product attributes like quality, features and design. The degree of consideration given to these attributes has far reaching implications on consumer's acceptance of the product. Some of the product attributes are;

**1. Product Quality**

Quality is one of the marketing manager's strategies of placing the product in the mind of the prospect or the consumer (i.e. positioning). Whenever a product is being developed, the issue of quality comes under two dimensions: level and consistency. In the first case, the marketing manager must choose a quality of a product to perform its functions, such as overall durability, reliability, precision, ease of operation, and repairs, as well as other valued attributes. The second consideration for quality is in respect of consistently delivering the targeted level of quality to consumers. Hence, there should be no defects in the products being offered to the market. In addition, no variations should be spotted in them.

It is realization of the need for high levels of quality consistency that firms At up quality control units. Generally, good quality control measures involve preventing defects before they occur, through better product design and improved manufacturing process.
In recent times, many business enterprises have embraced "Total Quality Management (TQM) as an important tool to constantly improve product and process quality in every facet of their activities. Such companies are gradually turning quality into a potent strategic weapon of gaining an edge over competitors by offering products and services that better serve customers' need and preferences for quality.

**2. Product Features**
Another important product attributes are the features a particular product processes. A product can be offered with varying features. A model without any extras (a "stripped - down" model) is usually the starting point. The company can simultaneously create higher-level models by adding more features. Consider automobile-manufacturing plant for example. A "stripped-down" model of the vehicles being produced will contain no extra features like air-conditioners, head rests, alloy rims, car stereo etc. However, the higher models which contain any one or combinations of these extras features are fast becoming a competitive tool for differentiating the company's products from competitors'. What is generally needed here is some high degree of innovativeness backed with a sound and efficient marketing research unit.

**3. Product Design**
The process of designing a product's style and function concerns creating that is attractive, easy, safe, and inexpensive to use and service. It should also be simple and economical to produce and distribute.
Just like product features, product design can be one of the most powerful competitive weapons in a company's marketing arsenal.
For instance, good designs can attract attention, improve product performance, cut production costs, and give the product a strong, competitive advantage in the target market.

### 3.3.2 BRANDING

A forward-looking marketing manager will usually consider the issue of branding, as part of his strategic plans. But what is a brand?
A brand is a name, term, sign, symbol or design, or a combination of these, which is intended to identify the products or services of one seller or group of sellers and to differentiate them from those of competitors. Therefore, a brand identifies the maker or seller of a product. It is a seller's promise to deliver consistently, a specific set of features, benefits, and services to buyers.

We must observe that the term branding includes brand names, brand marks and trademarks.

Brand name is narrower in meaning and is concerned with that part of a brand which can be vocalized (i.e. utterable or pronounceable). A brand name is defined as a brand or part of a brand consisting of a word, letter, group of words or letters, comprising a name, which identifies the goods or services of a seller or group of sellers and distinguishes them from competitors. Examples here include Coca Cola, Pepsi Cola, Peugeot, Toyota, Panadol, Bacchus. Brand mark is that part of a brand which can be recognized but is not utterable or pronounceable, such as symbols, designs or distinctive colouring or lettering. Examples. Lion head (for Peugeot).

A trademark is a brand or part of a brand that is given legal protection because it is capable of exclusive appropriation. A trademark usually protects the seller's exclusive rights to use the brand name and/or brand mark.

Branding is now an important issue in product strategy that can be viewed from two sides. On the one hand, developing a branded product requires a great deal of long-term marketing investment, especially for advertisement, promotion and packaging. Hence, some manufactures usually find it convenient and cheaper to make the product and let others do the brand building. This strategy is common with Taiwanese manufactures who make substantial proportion of the world's clothing, consumer electronics, and computers that are sold under non-Taiwanese brand names.

On the other hand, many manufacturers have come to realize that the power lies with the companies that control the brand names. For example, brand name clothing, electronics, and computer companies can replace their Taiwanese manufacturing sources with cheaper sources in Malaysia. It is however regrettable that the Taiwanese producers can do very little to prevent the loss of sales to less expensive suppliers.

Generally, branding adds value to consumers and society since it leads to higher and more consistent product quality. It also increases the degree of innovativeness in the business world by giving producers some incentives to look for new features that cannot be easily copied by competitors. In this sense, branding can be said to result in more product variety and choice for consumers. Finally, branding increases shoppers' efficiency by providing sufficient information about products and where to find them.

Apart from the above, branding has been observed to confer specific advantages on both the buyer and the seller.

Benefits to the Buyer:

Brand names inform the buyer about product quality. For instance, a buyer who purchases the same brand knows that he will obtain the same quality each time he buys.

Brand names also increase the shopping efficiency of the buyer. Since different products have their particular brand names, a buyer will find it easy to pick his choice from the pack instead of just aimlessly going through nameless products.
(iii) Brand names also assist in calling customers' attention to new products, especially when backed by aggressive promotional activities. .
Benefits to the Seller:
Brand names make it easier for sellers to receive and process orders, as well as track down problems. For example, a contract for the supply of vehicles will usually be specific about the particular model needed.

The sellers' brand name and trademark instantly give legal protection for unique product feature that otherwise might be copied by competitors.
Branding allows the seller attract loyal and profitable sets of customers.
Through branding, the seller is able to segment his markets and by so doing cater for the needs of the various segments in the market.

### 3.3.3 PACKAGING

Packaging has to do with the activities of designing and producing the container or wrapper for a product. The package may comprise of the following:
the product's primary container (e.g. the bottle holding bennylin cough a syrup);
a secondary package, that is thrown away when the product is about to be used (i.e. the card box containing the bottle of Bennylin cough syrup); and
the shipping package necessary to store, identify and ship the product (e.g. a corrugated box carrying larger volumes of the product).
In today's business, several factors have made packaging an important marketing tool. For instance, the increase in self-service dictates that packages must necessarily perform many sales tasks such as attracting attention, describing the products, as well as making the sale. In actual fact, innovative packaging can offer a company an advantage over competitors.
Labeling, which consists of printed information appearing on or with the package, should be seen as part and parcel of packaging. Labels may range from simple tags attached to products to complex graphics that are part of the package. They often perform at least two functions. In the first place, the label identifies the products or brand. Secondly, it may contain some useful information about the product such as its content, expiry date, direction for use etc.

### 3.3.4 PRODUCT-SUPPORT SERVICES

Another important element of product strategy is customer service. What a firm offers in the market place usually includes some services, which may be a minor or major part of the total offer. These are known as product-support services since they augment actual products.

Good customer service has its positive points. For instance, it costs less to keep the goodwill of existing customers that it does to attract new ones or win back lost customers. Firms that provide high quality service usually have the opportunity to charge more, grow faster and make more profits.
It is in this sense that many are now setting up strong customer service operations to handle complaints and adjustments, credit service, maintenance service, technical service, and consumer information. A well-staffed and equipped customer service department should be able to effectively coordinate al the firm's services, create consumer satisfaction and loyalty, and helps the firm to further be ahead of its competitors.

## 3.4 PRODUCT CLASSIFICATION

Several product classification systems have been devised for efficient marketing of products and services. In the first place, all products and services can be broadly grouped into two major classes on the bases of the types of consumers that use them. These classes are: consumer products and industrial products.

### 3.4.1 CONSUMER PRODUCT

These are goods or services bought by final consumer for personal consumption, in such a form that they may be used without further commercial processing.
The purpose of the marketing process is the satisfaction of consumers. Hence, to develop and market products effectively, it is necessary to know how customers feel about the products most especially their basis of choice. It follows form here that any sub-division of consumers' goods should be based on consumer behavior. In this regard, all customer goods can be separated into four categories.
1. Convenience products
2. Shopping products
3. Specialty products
4. Unsought products

**1. Convenience Products**
Convenience products are those products and services for which the probable gain from making price and quality comparisons is thought to be small relative to the value of the customer is time and efforts Examples include cigarettes, soap, newspapers, magazines, chewing gun and most grocery products. These products are frequently and readily purchased, require little service or selling efforts, are not very expensive, and may even be bought by habit.
Convenience products can be subdivided further into three types, based primarily on how customers think about and buy such products:
i. staples products
ii impulse products

iiiemergency products.

**Staples Products**:Staples such as food and drug items used regularly in every household, are usually bought without much thought beyond the initial decision to buy such products. Staples are usually purchased frequently. Here branding becomes important since brand recognition or preference helps the customer reduce his shopping effort. In addition, if prices change occasionally on these items, he does not need to reconsider which items to purchase, since he can make do with familiar ones.

**Impulse Products:-** These are products which customers typically do not seek, they are often purchased with little planning or search effort. These products are normally widely available. This is why candy bars, magazines, etc are placed next to checkout counters in many stores since shoppers may not otherwise think of buying them.
It has been observed that as the income and buying power of customers grow, the number of impulse items seems to the expanding. We should however note that not all impulse items are purchased for emotional reasons alone. To be sure, these products may satisfy both emotional and economic motives.

**Emergency Products:-** These are purchased only when the need is urgent, and are thus purchased less frequently. Considerations for price and quality is of little importance if the need is immediate enough. Examples include ambulance services, umbrellas or raincoats during a rainstorm.

**2. Shopping Products**

Shopping product are those for which the probable gain from making price, style, suitability and quality comparisons is thought to be large relative to the time and effort needed to shop properly for these products. Consumers spend much time and efforts in gathering information and making comparisons when buying shopping product. Examples include furniture , clothing, used cars, and major appliances.
Shopping products can be subdivided into two classifications, depending on what customers are seeking; (1) homogenous and (2) heterogeneous.
Homogenous Shopping products are seen by the consumer to be similar in quality but different enough in price to justify shopping comparison. Examples here include refrigerators, television sets, and automobiles. Thus, each competitor has an almost perfect elastic demand curve. In such a case, a slight price cut would substantially increase sales volume, therefore, we might expect price competition among the various competitors in the market.
Heterogeneous:-Shopping products are seen by the consumer as non-standardized, hence wants to inspect for quality and suitability because the product features are more important than price.

It is important therefore that a seller of heterogeneous shopping products carry a wide assortment to satisfy individual tastes. In addition, the seller must have well-trained sales people to give information and advice to customers since they often prefer to be guided. Furthermore, draperies, dishes and clothing are good examples of this categories of shopping product.

**3. Specialty Products:**
Specialty products are those consumer products with unique characteristics or brand identification for which or significant group of buyers is willing to make a special purchase effort. The special effort the consumer makes is not to compare the product with others, but merely to locate it, hence searching in the shopping products sense does not take place here. Specialty products are usually specific branded items rather than product categories, i.e. they are specific products which have passed the brand preference stage and reached the brand insistence stage. For instance, consumers have been observed asking for a drug product by its brand name, and when offered a substitute actually leaving the store in anger. Some well-advertised food and drug products seem to have carved out a market for themselves. If they achieve the brand insistence stage, we refer to them as specialty products. The demands for specialty products are relatively inelastic at least within reasonable price ranges since customers are willing to insist upon the product. Typical examples of specialty products include specific brands and types of cars, high-priced photographic equipment and custom-made men's suits.

**4. Unsought Products:**
These are consumer products that the consumer either does not know about or knows about, but does not normally think of buying. There seem to be two types of unsought products: Almost all new products in the introductory stages may be classified as "Unsought" until the consumer becomes aware of them through advertising. Yet there are some consumer products that seem to perpetually remain unsought for the majority of potential customers. Aggressive and continuous promotion is therefore necessary for both types to move new products out of this category and simply to sell the latter group (which very often never gets out of the introductory stage). Examples of unsought products include life insurance, encyclopedias, blood donation to the Red Cross.

### 3.4.2 INDUSTRIAL PRODUCTS

Industrial products are those purchased for further processing or for use in conducting a business. When this description is compared with that of consumer products, it would be seen that the distinction between then is simply based on the purpose for which the particular product was bought. For example, if a consumer buys a camcorder for the recording of important events for personal and private use, the camcorder is seen as a consumer product If on the other hand, the

consumer buys the same camcorder for the recording of events such as wedding, funeral, birthdays with the intention of receiving financial rewards, this camcorder is considered an industrial product.

Industrial product can be classified into three groups:

Materials and parts

Capital items

Supply and services

**1. Materials and Parts**

These are industrial products that enter the manufacturer's product completely, including raw materials and manufactured materials and parts.

Raw Materials include farm products(e.g. Maize, wheat, cotton, cocoa beans, livestock, fruits, vegetables etc) and are supplied by many small producers who turn them over to marked intermediaries that process and sell them. The other component of raw materials are natural products (e.g. lumber, fish, crude petroleum, iron ore etc). They usually have great bulk and low unit value, and require a lot of transportation to move them from producer to user. They are also supplied by fewer but larger producers, who often tend to supply these products directly to industrial users. Manufactured materials consist of component materials (e.g. yam, cement, wires, iron etc) and component parts (e.g. castings, engines, tires, bulbs etc).

**2. Capital Items**

Capital items are industrial products that aid in the buyers production or operations. These are composed of (i) installations and (ii) accessory equipment.

Installations are large and expensive items which do not become a part of the final product but instead are used up over many years. They represent major expenditures for the firm and are depreciated over a long period. In addition then are bought directly from the producer. Examples of installations include buildings (e.g. factories, offices) and fixed equipment's (e.g. generators, drill presses, large computers, elevators)

Accessory equipment like their installation counterparts do not become a part of the final product. They are usually less expensive and shorter-lived than installations. Products in this category include tools and equipment which facilitate production or office activities. Examples include potable drills, lift trucks, typewriters, fax machines, desks, filing cabinets wheel barrows etc).

**3. Supplies and Services**

These are industrial products that do not enter the finished product at all. Supplies include operating supplies (e.g. lubricants, coal, computer paper, pencils) and repair and maintenance items (e.g. brooms,. nails, paint etc.). In some respects, supplies are the convenience products of the industrial field because they are usually purchased with a minimum of efforts and comparison.

Services are frequently necessary or desirable to plan, facilitate or support operation. Business services include maintenance and repairs services (e.g. window cleaning, computer and machinery repair etc) and business advisory services (legal, management consulting, advertising etc.).

## 4.0 CONCLUSION

Production is the first and the most important element in the marketing mix. A product can be defined as a set of tangible and intangible attributes, including packaging, colour, price, quality and brand, plus the seller's services and reputation. A product may be a good, service, place, person or idea. In essence, then, consumers are buying much more than a set of physical attributes when they buy a product. They are buying want satisfaction in the form of the benefits they expect to receive from the product.

## 5.0 SUMMARY

To manage its products effectively, a firm's marketers must understand the full meaning of a product, which stresses that consumers are buying want satisfaction. Products can be classified into two basic categories i.e, consumer products and industrial products. Each category is then subdivided, because a different marketing program is required for each distinct group of product.

## SELF-ASSESSMENT EXERCISE

1. Compare the elements of a producer's marketing mix for a convenience good with those of the mix for a speciality good.
2. In which of the five categories of business goods, should each of the following be included? And which products may belong in more than one category?

Trucks
Medical X-ray equipment
Typing paper
copper wire
printing paper

## 6.0 TUTOR-MARKED ASSIGNMENT

1. Analyse two primary functions of packaging.

## 7.0 REFERENCES/FURTHER READINGS

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## UNIT 11: PRODUCT-MIX STRATEGIES

### CONTENTS

1.0 Introduction
2.0 Objectives
3.0 Main Contents
3.1 Product Mix and Product Line
3.2 Product-Mix Strategies
3.3 Product Life Cycle
4.0 Conclusion
5.0 Summary
6.0 Tutor-Marked Assignment
7.0 References/Further Readings

### 1.0 INTRODUCTION

A product mix (also called product assortment) is the set of all products and items that a particular seller offers for sale. Over time, a company needs to make numerous decisions about this array of products. The correctness or otherwise of such decisions greatly affects the company's degree of success over some time. In this unit, you will learn a number of strategic decisions pertaining to an organization's assortment of products.

### 2.0 OBJECTIVES

After studying this unit, you should be able to:

- Differentiate between product mix and product line;
- Explain the major product-mix strategies;
- Explain the meaning of the terms, "trading up" and "trading down"
- Understand the concept of product life cycle.

### 3.0 MAIN CONTENTS

### 3.1 PRODUCT MIX AND PRODUCT LINE

As you will come to fully understand later in this course, few firms rely on a single product. Rather, most companies deal in many products. The set of all products and items that a particular seller offers for sale is called a product mix or product assortment.

A company's product mix has a certain width, length, depth, and consistency:

The width of a product mix refers to how many different product lines the company carries. The length of product mix refers to the total number of items in the mix From this, we can also talk about the average length of a line. This is found by dividing the total length by the number of lines.

The depth of a product mix refers to how many variants are offered of each product in the line. For example, if a product, such as toothpaste, comes in three different sizes (small, medium, and large) and two formulations, (regular and smoker's), that particular product has a depth of six, the consistency of the product mix refers to how closely related the various product lines are in end use, production requirements, distribution channels or some other way. A company's product lines are said to be consistent, for instance if they are consumer goods that go through the same distribution channels. The lines are less consistent if they perform different functions for the buyer.

These four product-mix dimensions allow the company to expand its business in four ways. In the first place; it can add new product lines, thereby widening its product mix. Secondly, it can lengthen each product line. Thirdly, it can add more product variants to each product, thereby deepening its product mix. Fourthly, the company may pursue more product-line consistency.

Let us now formally define a product line: A broad group of products, intended for essentially similar uses and having similar physical characteristics, constitutes a product line. In offering a product line, companies normally develop a basic platform and modules that can be added to meet different customer requirements. For instance, car manufacturer build their cars around a basic platform. Home builders show a model home around which additional features can be added.

## 3.2 PRODUCTS-MIX STRATEGIES

You were informed in section 3.1 that most companies carry a diverse assortment of products. For instance, you may find a particular company dealing in baked goods, snack foods, family entertainment and different brands of soft drinks. This wide variety of good has not been developed by accident. Rather, it reflects a planned strategy by the company. This is to say that to be successful in marketing, producers and middlemen need carefully planned strategies for managing their product mixes. This would be made clearer in the sections that follow.

### 3.2.1 POSITIONING THE PRODUCT

A company's ability to bring attention to a product, as well as differentiate it in a favourable way from similar products goes a long way toward determining that product's revenues and the company's profits. Therefore, it is important for companies to engage in positioning. Positioning means developing the image that a product projects in relation to competitive products and to the firm's other products.

You need to understand that positioning is not what you do to a product. It is what you do to the mind of the prospect. That is, you position the product in the mind of the prospect. This is the reason why well-known products generally hold a distinctive position in consumers' mind.

There are a member of positioning strategies that marketing execution can choose from. It is also possible to employ more than one strategy. Let us examine the available strategies:

1. Positioning in Relation to a Competitor:

Positioning directly against the competitor is the best strategy for some product. This strategy has been found to be especially suitable for a firm that already has a solid differential advantage or is trying to solidify such an advantage. For example, in order to ward off rival makers of microprocessors, Intel corp. launched a campaign to convince buyers that its product is superior to competitors'. To reap maximum benefits, the company even paid computer makers to include the slogan, "Intel Inside", in their advertisements. You should be familiar with this label on personal computers and even in newspaper advertisements. In some other products however, head-to-head positioning should never be done, especially when a competitor has a strong market position.

The market leader will do everything to frustrate such moves, and this might eventually lead to the failure of the contender.

2. Positioning in Relation to Product class or Attribute:

At times, a company's positioning strategy entails associating its products with a product class or attribute. Sometimes, however, the company might want to actually dissociate its products from a product class or attribute. For instance, some firms promote their products as having an attractive attribute, such as "low energy consumption", or "environmentally friendly". These days, this strategy is now widely used for food products. For example, some food products are being labeled as containing little or no salt, sugar, fat, or cholesterol. Such items are positioned against products that are packed with the conventional amount of salt, calories, cholesterol or fat content.

3. Positioning by Price and Quality:

There are two extremes here. On one side, some producers and retailers may opt for high quality and high prices strategy. On the other side, are discounters who stress low prices. This is not to infer that discounters ignore quality.

Positioning in Relation to Target Market

Whatever positioning strategy is adopted, the needs of the target market must always be considered. This is consistent with our discussion on satisfying the needs and wants of the prospective customer.

### 3.2.2 PRODUCT-- MIX EXPANSION

Product — mix expansion is accomplished by increasing the depth within a particular line and / or the number of lines a firm offers to consumers. An illustration of the options would make the strategy clearer to you. When a company adds a similar item to an existing product line with the same brand name, this is termed a line extension. A firm many engage in line extension for several reasons. The major one is that the firm wants to appeal to more market segments by offering a wider range of choices for a particular product. Another way to expand the product mix, known as mix extension, is to add a new product line to the company's present assortment. Under this strategy, the new line may or may not be related to current products. In addition, it may carry one of the company's existing brand names or may be given an entirely new name. With these situations, a company has four alternatives:

(i) Related product, same brand
(ii) Unrelated product, same brand
(iii) Related product, different brand
(iv) Unrelated product, different brand.

### 3.2.3 TRADING UP AND TRADING DOWN

Trading up and trading down strategies involve a change in product positioning as well as an extension of the product line, in the case of trading up, a higher-price product is added to a line in order to attract a broader market. Another reason for adopting this strategy is that the added product's prestige might help the sale of the existing lower-price products.

Trading down strategy entails adding a lower-price product to a company's product line. It is expected that people who cannot afford the original higher-price product or who see it as too expensive will buy the new lower-price product. The reason for this is simple: the lower-price product carries some of the status and some of the• other more substantive benefits (such as performance) of the higher-price item.

It is possible to practice the trading down strategy without necessarily introducing new, lower-price product. This is usually done or achieved through advertising. For instance, a manufacturer of wrist watches might accomplish this by advertising some of the lower-price items in its existing product lines. You should note that trading up and trading down strategies could be very dangerous, especially since the new product may confuse buyers, thereby resulting in negligible net gain. It is equally undesirable if sales of the new item or line are

generated as the expense of the established products. For instance, when trading down, the new products may permanently hurt the firm's reputation as well as that of its established high-quality product. In order to run away from this damage, the new lower-price products may be given brand names that are different from the established brands.

With respect to trading up, the problem actually depends on whether the new product or line carries the established brand name is adopted, it is necessary for the company to change its image so that new customers will accept the higher-price product. Ironically, the seller does not want to lose its present customers. Thus, the new offering may present a cloudy image, not attracting new customers but driving away existing customers. If a different brand name is used, the company must create awareness for it, and then stimulate consumers to buy the new product.

### 3.2.4 ALTERATION OF EXISTING PRODUCTS

Instead of developing a completely new product, management could take critical look at the company's existing product-mix. The firm can thus adopt the strategy of product alteration, by improving an established product. This strategy may actually be more profitable and less risky than developing new products. However, product alteration has some inherent risks. For instance, when Coca-Cola Bottling Company modified the formula for its leading product (i.e. Coca-cola) and changed its name to New Coke, sales dropped drastically. The company was subsequently forced to bring the old formula back three months later under the classic Coca-cola brand name.

Another possible alternative, especially for consumer goods, is to change the products packaging, instead of the product itself. Companies often have been found to alter products' packaging to enhance appearance or to improve the product's usability.

### 3.2.5 PRODUCT — MIX CONTRACTION

Product-mix contraction is carried out either by eliminating an entire line or by simplifying the assortment within a line. The main objective of this strategy is to obtain higher profits from fewer products. In this case, thinner and / or shorter product lines or mixes can weed out low-profit and unprofitable products. Generally, as firms discover that they have an unmanageable number of products or that various items or lines are unprofitable or both product-mix pruning is the best bet.

## 3.3 PRODUCT LIFE CYCLE

Products like human beings have a life cycle. The product life cycle (PLC) concept takes an important place in the development of product mix strategy. It serves to identify the competitive environment for new products, and to identify alternative competitive environment for new products. In order words, it helps to assess the changing nature of competition, costs, and market opportunities over time. The following four points must be considered in the life cycle of a product:

(i)Products have a limited life
(ii)Product sales pass through distinct stages, each posing different challenges, opportunities and problems to the seller.
(iii)Profits rise and fall at different stages of the PLC.
(iv)Products require different marketing, financial, manufacturing, purchasing and human resource strategies in each stage of their life cycle.

Normally, one would expect that a product's sales potential and profitability will change overtime. The PLC is thus an attempt to recognise distinct stages in the sales history of the product. From birth to death, the cycle is typically divided into four stages these are: Introduction, growth, maturity and decline.
The length of the cycle varies among products, ranging from a few weeks or a short season (e.g. a fad or apparel fashion) to several decades (e.g. autos or telephones). The duration of each stage may also be different among products. For instance, some take years to pass through the introductory stage, while others are accepted in a few weeks. We should also note that not all products go through all stages: Some may die off in the introductory stage. However, in virtually all cases decline and possible death are unavoidable for certain reasons, which may be that:the need for the product has disappeared; a better or less expensive product is developed to fill the same need; or a competitor does a superior marketing job.

### 3.3.1 ENVIRONMENTAL CHARACTERISTICS AND MARKETING STRATEGIES FOR THE STAGES

**(1) Introductory Stage:**
The product is new to the market, and most buyers have not even tried it since little is known about the product. In many respects, the introductory stage is the most risky and expensive one. This is why there is the high percentage of product failures at this period. Operations in this introductory period are characterized by high costs, low sales volume, and limited distribution. For really new products, there is very little competition. The promotional programme stimulates primary, rather than secondary demand. Profits are non-existent at this stage because of the heavy expenses on productintroduction.
Possible Marketing Strategies for the introductory stage, when introducing a new product to the market, marketing managers can set a high or a low level for each marketing variable, such as price, promotion, and product quality.

If we assume product quality to be constant, price and promotion can be employed to pursue one of the four strategies shown in Table 1 below.

| PROMOTION | High | Low |
|---|---|---|
| High | Rapid — Skimming Strategy | Slow — Skimming Strategy |
| Low | Rapid — Penetration Strategy | Slow — Penetration Strategy |
| | High PRICE | Low |

Table 1: Four Introductory Marketing Strategies

(a) Rapid— Skimming Strategy

This consists of launching the new product at a high price and a high promotion level. A high price is being charged because the firm wants to recover as much gross profit per unit as possible. In addition, the firm spends heavily on promotion in order to convince the market of the products' merits even at the high price level. The high promotion acts to accelerate the rate of market penetration. This strategy is applicable under the following conditions: a large part of the potential market is unaware of the product;
those who become aware are eager to have the product and able to pay the asking price; and the firm faces potential competition and wants to build up brand preference.

(b) Slow — Skimming Strategy

Under this strategy, the new product is launched at a high price and low promotion. As usual, the objective of the high price is to recover as much gross

profit per unit as possible. The low level of promotion is to keep the marketing expenses down. This particular strategy is expected to skim a lot of profit from the market. This strategy is applicable under the following conditions:
(i)The market is limited in size;
(ii)Most of the market is aware of the product;
(iii)Buyers are willing to pay a high price; and
(iv)Potential competition is not imminent.

(c) Rapid-Penetration Strategy

This consists of launching the product at a low price and spending heavily on promotion. From this attractive combination, the strategy hopes to bring about the fastest market penetration and the largest market share. The strategy is applicable under the following conditions:
the market is large;
the market is unaware of the product;
most buyers are price sensitive;
there is strong potential competition; and
the company's unit manufacturing experience.

(d) Slow-penetration Strategy

This consists of launching the new product at low price and low level of promotion. The low price is expected to encourage rapid product acceptance. The firm also keeps its promotion costs down in order to realize more net profit. The firm believes that market demand is highly price elastic, but minimally promotion elastic. The strategy is applicable under the following conditions:
(i)The market is large;
(ii)The market is highly aware of the product
(iii)The market is price sensitive; and
there is some potential competition.

**(2) Growth Stage:** The product becomes widely known and sales grow rapidly, leading new competitors to enter the market. There is substantial profit improvement at this stage. Sellers shift to "buy-my-brand" rather than "try my-product" promotional strategy i.e. emphasis now on secondary demand. The number of distribution outlets increases, economies of scale is introduced, and prices may come down a bit

Possible Marketing Strategies in the Growth Stage
The firm uses several strategies to sustain market growth as long as possible. Such strategies include:

(i) Improving product quality and adding new-product features and models entering new market segments
(ii) Entering new distribution channels shifting some advertising from building product awareness to bringing about product conviction and purchase.
(iii) Lowering prices at the right time to attract the next layer of price-sensitive buyers.

**(3) Maturity Stage:** This is a period of slowdown in growth because the product has achieved acceptance by most of the potential buyers. Repeat purchases dominate sales and only the strongest competitors remain in the business. Marginal producers are forced to drop out of the market. Price competition becomes increasingly severe, and the producer assumes a greater share of the total promotional effort as he fights to retain his dealers and the shelf space in their stores.

Possible Marketing Strategies in the Maturity Stage
Most firms tend to passively defend their products in the maturity stage. Their opinion is that it is best to conserve money and spend it on newer products. However, we should understand that attack is the best form of defense. The following marketing strategies are often used:
(i)Market modification
(2)Product modification
(3)Marketing — mix modification

**(4) Decline Stage:** Sales slowly decline because of changing buyer needs or the introduction of substitute product forms or product classes. Cost control becomes increasingly important as demand drops. Advertisement declines, and a number of competitors withdraw from the market.

Possible Marketing Strategies in the Decline Stage
The appropriate decline strategy is a function of the industry's relative attractiveness and the firm's competitive strength in the industry. The following are some of the general strategies in use:
(i)Increasing the firm's investment (to dominate or get a good competitive position). Holding the firm's investment level until the uncertainties about the industry are resolved.
(ii)Decreasing the firm's investment posture selectively, by sloughing off the unpromising
customer groups, while simultaneously strengthening the firm's investment positions within the lucrative niches of enduring customer demands.
(iii)Harvesting (or milking) the firm's investment to recover cash quickly, regardless of the resulting investment posture.

(iv)Divesting the business quickly by disposing of its assets as advantageously as possible.

### 3.3.2 EXTENDING THE PRODUCT LIFE CYCLE.

From our discussions so far, you can see that marketers face choices that can change the products course in every stage of the PLC. For instance, by manipulating the product, the promotion, the pricing, and the distribution, you can give your products at least a temporary sales boost.
Usually, no PLC is static, hence, it is possible to extend it once close attention is paid to the marketing environment In actual fact, products that have been discontinued can make a comeback. This is possible through product modification and careful timing. Another way to extend the life cycle is to position the product for other uses or other audiences.

### 3.3.3 IMPORTANCE OF PRODUCT LIFE CYCLE (PLC) TO MANAGEMENT

A careful study of the stages in the PLC suggests that each would present distinct opportunities and problems with respect to marketing strategy and profit potential. By knowing the stage that a product is already in, or is moving toward, firms, can formulate better marketing plans. In particular, the PLC can be useful to management for several reasons.
First, it tells more about the difficulty and cost of increasing market share than the current brand growth rate would do. Low growth may occur in the introductory stage or in the maturity phase. It should however be observed that the ability to improve market share is more limited in the maturity stage because of the following reason:
(i)The products are technologically on a par with each other, consumer preferences tend to be well established, and
(ii)The vast majority of sales is replacement or repeat purchases, suggesting that increased sales must come primarily from competitors rather than from new users.

Second, the PLC suggests that product redesign, product reformulation, or minor product variations should be developed when maturity is reached, as a means of revitalizing sales through modifying the product form or class.

Third, knowing the stage of the PLC enables a firm to project future costs and profits. For instance, marketing costs, especially advertising tend to be greatest in the introduction and early growth stages of the life cycle. In the introduction stage, extensive advertising and selling efforts are required to communicate the basic benefits derivable from the new form or class. During the early growth stage, high marketing expenses from promotion and minor product modifications are needed

as firms compete for strong market-share positions so as to withstand the attacks of competitors that usually show up at maturity. Lastly, in the late growth and maturity, product modification, improvement, or proliferation may result in increased production and inventory costs.

The PLC concept indeed offers valuable tool for a marketing manager since it enables him to understand the competitive environment in which each brand or product form must operate. Through the examination of the PLC, managers can better understand the opportunities and constraints facing individual brands and product forms, together with the associated costs of improving or maintaining market share for products.

## 4.0 CONCLUSION

The product portfolio is a combination of products and product lines balanced to achieve the company's overall profit objective, while satisfying the needs of its target markets. The portfolio concept helps marketers consider individual products within the context of the entire line and the complete mix, allocating more money to products and lines that have attractive current or future sales or that are competitively strong.

## 5.0 SUMMARY

Most companies sell more than one product. The set of all products offered for sale by a company is called a product mix. A product mix can be classified according to width, length, depth and consistency. These four dimensions are the tools for developing the company's marketing strategy and deciding which product lines to grow, maintain, harvest and divest.

Self-Assessment Question

1. Describe how marketers manage the product mix by introducing products, discontinuing products and modifying products.

Solution

As you manage the product mix, you have the choice of modifying products, discontinuing products, or adding products.

The goal is to create a product mix that meets the needs of the target audience, with new products, existing products, and repositioned products. How you treat individual products depends on your company's profit and market share objectives.

Also, when deciding whether to add, modify, or discontinue a product, you monitor changes in the marketing environment, such as emerging technology, competitor actions, and shifting consumer tastes.

When a product moves into the decline stage of its life cycle and sales go down with no sign of rebounding, you consider modifying the product, discontinuing it, or adding a new product in its place.

## 6.0 TUTOR-MARKED ASSIGNMENT

1. Discuss how marketers use the marketing mix to manage products throughout the Plc.

## 7.0 REFERENCES/FURTHER READINGS

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# UNIT 12: NEW PRODUCT DEVELOPMENT

## CONTENTS

1.0 Introduction
2.0 Objectives
3.0 Main Content
3.1 What is a New Product?
3.2 The New Product Development Dilemma
3.3 Organizing New Product Development
3.4 Product Development Objectives
3.5 The Product-Development Process
4.0 Conclusion
5.0 Summary
6.0 Tutor-Marked Assignment
7.0 Further Reading

## 1.0 INTRODUCTION

In our previous discussions, a product was defined as anything that can be offered to a market for attention, acquisition, use or consumption that might satisfy a want or need. In this regard, a product might be said to include physical objects, services, persons, places, organizations, and ideas. In addition, every product should be seen as the packaging of a problem-solving service.

Again, we have also stressed that, every product seems to go through a life cycle i.e. it is born, goes through several phases, and eventually dies. Newer products show up in the market to serve the consumer better than the dead one. These new products would also suffer the same fate as the previous ones, and another cycle begins. This product life cycle poses one important challenge to organizations: since all product eventually decline (in sales or acceptance), the firm must find

new products to replace aging ones. The focus of this unit therefore is on new product development.

## 2.0 OBJECTIVES

After studying this unit, you should be able to:

- define a new product
- explain why new products are important to firms
- discuss the major reasons for new product failures
- outline the steps in the new product development process.

## 3.0 MAIN CONTENT

### 3.1 WHAT IS A NEW PRODUCT?

Any product that consumers treat as an addition to the available choices could be considered a new product. From the viewpoint of the firm, however, new products are those products that are new to the company.
Mining can obtain new products in two ways: (a) acquisition (b) new product development.
The acquisition route can take three forms:
1. The firm can pursue a corporate-acquisition programme involving the search for small companies that have attractive product lines;
2. The firm can pursue a patent-acquisition programme, in which it buys the rights to new products from their patent holders.
3. The firm can pursue a license-acquisition programme for manufacturing various products. It should be observed from all the three cases above that the firm does not develop any new products, but simply acquires the rights to existing ones.

The new product route can take two forms:
1. The firm can pursue internal product development by operating its own research and development (R&D) department.
2. The firm can pursue contract-new product development. This involves hiring independent researchers or new product development agencies to develop specific products for the firm.

### 3.2 THE NEW PRODUCT DEVELOPMENT DILEMMA

Firms are often free to select any one or a combination of these strategies for their development. Generally, new products account for a high proportion of growth in many firms and are usually major contributors to overall profits for these businesses.

Under modern conditions of competition, firms that do not develop new products are merely exposing themselves to risks of business closure. Such firms will find their products falling victim to changing consumer needs and tastes, new technologies, shortened product life cycles, and increased domestic and foreign competition.
On the other hand, new product development can be very risky. A variety of researchers have investigated the rate of failure associated with new products. It has been reported that between 33% to 98% of the new products introduced fail to achieve commercial success.

### 3.2.1 REASONS FOR NEW-PRODUCT FAILURES

Several factors have been found to be responsible for new product failures:
1. Dictatorial tendencies of top management: some high-level executive might push a favourite idea through in spite of negative marketing research findings.
2. Over-estimating of market size: The project idea might be good, but the market size may be over-estimated.
3.Product deficiencies: The actual product might not be properly designed to fit the needs and wants of prospective consumers. This often results in poor quality and performance. 4. The product may turn out to be too complicated and might not offer any significant advantage over competitive products already on the market.
5. Lack of effective marketing effort: There could be failure to provide sufficient follow- through effort after introductory programme, and failure to train marketing personnel for new products and new markets. In addition, the product might be incorrectly positioned in the market, or even overpriced.
6. Higher costs than anticipated: This often results to higher prices, with the attendant lower sales volume than projected.
7. Competitors' strength/reaction: The competitors might fight back harder than expected. In addition, the speed and ease of the copying an innovation may overcrowd the market sooner than expected.
8. Poor timing of introduction: The new-product might make a premature entry into the market. In some other instances, the product might be introduced too late
9. Technical or production problems: The firm might not be able to produce sufficient quantities to meet demand. In the process, competition might gain an unanticipated share of the market.

To compound the problems faced by firms, it has been speculated that successful new products may even be more difficult to achieve in the future for the reasons given below:

1. Shortage of important new-product ideas in certain areas: For instance, some scientists claim that there are too few new technologies of the investment magnitude of the automobile,

television, computers, xerography, and wonder drugs.
2. Fragmented markets: The intense competition being witnesses is leading to rapid fragmentation of markets. Hence, companies have to aim new products at smaller market segments rather than the mass market with the resultant lower sales and profits for each product.
3. Social and governmental constraints: New products have to satisfy public criteria such as consumer safety and ecological compatibility.
4. Costliness of the new-product-development process: A company typically has to generate many new-product ideas in order to finish with a few good ones. It should be noted that each product costs more to develop and launch due to the effect of the recent inflation on manufacturing, media, and distribution costs.
5. Capital shortage: Many companies cannot afford or raise the funds needed to research true innovations. Thus, they emphasize new product modifications and imitations instead of true innovation.
6. Shorter growth periods for successful product:When a new product is successful, rivals quickly jump into the arena to imitate the product, so much that its growth stage is shortened.

## 3.3 ORGANISING NEW PRODUCT DEVELOPMENT

Faced with the above problems how then can we have successful new-product introductions? There are two sides to this. In the first place, the organization must improve its organizational arrangements for handling the new-product -development process. Secondly, the organization needs to handle each step of the process with all seriousness, including using the best available techniques.

### 3.3.1 EFFECTIVE ORGANISATIONAL ARRANGEMENT

Since top management bears the ultimate responsibility for the quality of the new-product-development work, it must start with a clear definition of company growth strategy that specifies the business domains and product categories in which the company wants to do business. Apart from this, top management should also set specific criteria for new product-idea acceptance. The criteria can vary with the specific strategic role the product is expected to play. Such roles may include:
(a) Maintaining position as a product innovator defending a market-share position
(b) Establishing a foothold in a future new market Pre-emptying a market segment
(c) Exploring technology in a new way
(d) Capitalizing on distribution strengths.

The consideration of the acceptance criteria may be based on the following:
(a) A specified period within which the product can be introduced e.g five years
(b) A stated minimum market potential and growth rate e.g at least 30 million and a 10 percent growth rate

(c) Expected returns e.g at least 25 percent return on sales and 35 percent on investment

Technical/market leadership.

Furthermore, top management must determine the budget outlay for new product-development; Since R&D outcomes are so uncertain, it becomes a little bit difficult to use normal investment criteria for budgeting. A number of alternative ways exist towards finding a useful solution to this problem. These include:

1. Encouraging and financing as many project proposals as possible, hoping to hit a few winners;
2. Setting R&D budgets by applying a conventional percentage-to-sales figure;

spending what competition spends;

3. Working backwards to estimate the required R&D investment after keeping the number of successful products needed.

### 3.3.2 E STABLISHING A WORKABLE ORGANISATIONAL STRUCTURE

Another important factor in effective product-development work is to establish workable organizational structures. The following are some of the ways being adopted by different organizations:

1. Product managers: Some firms entrust new-product development to their product managers. Two notable faults have been detected in this system. Firstly, product managers are usually so busy managing their existing/current product lines that they give little attention to new products other than brand modifications or extensions. Secondly, product managers have been found to lack the specific skills and knowledge needed to develop new products.

2. New-product managers: This system professionalizes the new-product function. However, new-product managers tend to think in terms of product modifications and line extensions limited to their product market.

3. New-product department: In order to support new-product development as a full-time activity, some manufacturers usually set up a new-product department. This small department is headed by a manager who has substantial authority, as well as access to top management. Typically, these departments are responsible for generating and screening new ideas, directing and controlling R&D work, and carrying out field testing and pre-commercialization work. When a product is ready for full-scale commercial marketing, it is turned over to the appropriate operating department.

4. Product planning committee: Organizations that make use of this approach often have a high-level management committee charged with reviewing new-product proposals. The committee is usually made up of representatives from marketing, manufacturing, finance, engineering, and other relevant departments. After the product has successfully passed through the introductory stages of development,

the marketing responsibility for it is then taken over by another unit - e.g a product manager or a new-product department. The advantage here is that, in a committee, the ideas and wisdom of several executives can be pooled. In addition, any new product resulting from the committee's work is likely to win the approval of the administrators who took part in its development. However, one major disadvantage of this system is that committee activity takes much valuable executives time and slows the decision-making process.
5. Venture Team. This is a relatively new, rapidly growing organizational concept for managing product innovation from idea stage to full-scale marketing. The venture team is designed to avoid the product-development problems in traditional organizational structure. Such problems include bureaucratic operation, reluctance to change, and lack of authority to move a product through the developmental stages. Generally, a venture team is a small, multidisciplinary group, organizational removed from the main stream of the firm. This team is made up of representatives from engineering, production, finance and marketing research. The main goal of the venture team is to enter a new market profitably. The group is able to work in an entrepreneurial environment since it sees itself as a separate small business entity. It is usual for the group to report directly to top management. Immediately the new product reaches the stage of being commercially viable, it is typically turned over to another division, such as an existing unit, a new division, or even a new subsidiary company. The venture team is then disbanded. In some cases however, the team may be allowed to continue as the management nucleus when a new company is established.

## 3.4 PRODUCT DEVELOPMENT OBJECTIVES

It is very important to clearly state the objective of the product-development effort in order to provide direction for product-development decisions. Generally, product-development programmes may be designed to implement the corporate marketing plan or to implement the marketing strategy for a given product or product line.
There are four basic types of product-development programmes, each of which is designed to fulfill specific objectives. These programmes include:
1. Product-line modification programmes
2. Product-line extension programmes
3. Complementary-product programmes
4. Diversification programmes.

An organization may employ any one or a combination of these programmes to achieve different product-development objectives.

### 3.4.1 PRODUCT-LINE MODIFICATION PROGRAMMES

These programs are generally employed with the primary objective of enhancing sales of the present line.

They may be useful in implementing a customer-retention marketing strategy for the purposes of:

(a) meeting changing buyer needs
(b) meeting new competitive offerings or
(c) Improving satisfaction with the product.

Redesigning or reformulating the product to provide new benefits or to improve Product quality; or by using multiple packaging in order to reduce competitors' opportunities.

We may note that product modification programmes may enhance sales just by stimulating primary demand through increasing the rate of purchase. For instance, major design changes may result in a faster replacement rate for durable goods. In particular, modest packaging changes can lead to more rapid consumption of the product.

### 3.4.2 PRODUCT-LINE EXTENSION PROGRAMMES

The primary objective of product-line extension programmes is to reach anew segment of a market. Basically, these programmes may be employed to:

(a) acquire competitors' customers in segments where a firm presently does not have an offering, or
(b) stimulate demand among current nonusers of a product form.

In these two situations above, an entirely new product must be created with product features distinguishing it from the current offering.

### 3.4.3 COMPLEMENTARY-PRODUCT PROGRAMMES

Complementary product programmes seek to introduce products that can be generally used with existing products. The objectives of these programmes may be two-fold: either to enhance sales of existing products or to establish sales growth in related markets.

Complementary products have been found to enhance the sales of existing products. For example, a flash attachment to a camera will enable the customer to use the product in more situations, and will thus enhance the quality of the photographs taken. In another way, a complementary product may be introduced simply to take advantage of a company's brand name, image, or sales force. For example, a tyre manufacturing firm may add the production of tubes as complementary products.

### 3.4.4 DIVERSIFICATION PROGRAMMES

Diversification programmes are designed to establish a firm in new markets in order to achieve objectives such as new growth opportunities OR sales stability. Generally, diversification is a policy of adding new products to serve new markets.

## 3.5 THE PRODUCT-DEVELOPMENT PROCESS

The specific process used in implementing product-development programmes varies among organizations. However, it is important that they employ logical, sequential processes with full recognition of the role that product is expected to play in corporate and marketing strategy. The advantage of having such a structured approach is to provide some mechanism for evaluating a new product idea at several points in time as additional information is developed. Hence in each stage, management must decide whether:
(i) to move to the next stage;
(ii)to abandon the product; or
(iii)to seek additional information

There are eight stages in the product-development process:
1.Idea generation
2.Screening
3.Concept development and testing
4.Marketing strategy
5.Business analysis
6.Product development
7.Market testing and
8.Commercialization.

### State 1: Idea Generation

New-product development starts with an idea. Generally, ideas can come from a variety of sources, it is however desirable to establish a formalized approach to generating new-product alternatives. This entails incorporating the firm's product-development objectives. In other words, a systematic approach should be established to search for ideas that will meet current primary objectives. In addition, top management should define the product and markets to emphasize. Furthermore, it should state how much effort should be devoted to developing original products, modifying existing ones, and imitating competitors' products.

Sources of New-Product Ideas
New-product ideas often come from many sources including the following:
1. Customers: Our earlier understanding of the marketing concept suggests that customers' needs and wants should be the logical places to start in the search for new-product idea. In this sense, films can identify customers' needs and wants

through direct customer surveys, projective tests, focus group discussions, as well as suggestions and complaints letters from customers.
2. Scientists: Many organizations in the chemical, electronics and pharmaceutical industries rely on their scientists for new product ideas.
3.Competitors' product: New product ideas can also be generated by monitoring competitors' products. For instance, firms can listen to distributors, suppliers and sales representatives in order to know the position of things in the market. In addition, firms can assess who is buying competitors' new products together with the particular reasons for making the new purchase. Furthermore, firms can buy competitors’ products, dismantle them, and build better ones. This is known as product imitation and improvement rather than product innovation.
4.Firm's sales representatives and dealers: These are important sources of new product ideas. Their activities on the field usually endow them with firsthand exposure to customers' needs and complaints. They are usually the first to learn of competitive developments.
5. Top management: This is another major source of new-product ideas. However, as we already observed (under reasons for product failures) this might not be good enough, since a top executive may push through a pet idea without thoroughly researching market size or interest.
6. Miscellaneous sources: Other sources include investors, patent attorneys, university and commercial laboratories, industrial consultants, advertising agencies, marketing research films, and industrial publications.

**Stage 2: Idea Screening**

The purpose of this stage is to reduce the large number of ideas generated from the previous stage (i.e idea generation)". Basically, idea screening rates the general desirability of the new product concept to the firm. For instance, even when a concept is being viewed as marketable, the same concept may be seen as inappropriate for a firm that lacks the specific resources needed to produce and market it successfully.
The following aspects are usually given proper considerations in the rating scheme for evaluating new product ideas: marketability, durability, productive ability and growth potential (See Table 2)

Table 2: Major Considerations in Idea Screening

| Aspect | Considerations |
|---|---|

| 1.Marketability | Relation to present distribution channels Relation to present product lines Quality-price relationship Number of sizes and grades Merchandisability Effects on sales of present products |
|---|---|
| 2. Durability | Stability Breadth of market Resistance to cyclical fluctuations Resistance to seasonal fluctuations Exclusiveness of design |
| 3. Productive Ability | Equipment necessary Production knowledge and personnel necessary Raw materials availability |
| 4. Growth Potential | Place in market Expected competitive situation-value added Expected availability of end users. |

It should be clear from Table 2 that a variety of market-based internal and external factors are often considered. Therefore, screening must generally be carried out by a multifunctional group such that relevant inputs might be collected from production, finance, R&D, and marketing.

Apart from the four general aspects contained in Table 2, it is also important to check whether the product idea is consistent with the current product-development objectives. In this regard, a good idea that has scaled all the hurdles of the screening factors may be rejected or stepped down, if it will absorb resources needed to achieve the top priority objectives.

In this screening stage, the firm must avoid two types of errors: a DROP-error or a GO-error.

A DROP-error occurs when the company dismisses an otherwise good idea.

It is often said that if a firm markets too many DROP-errors, its standards are too conservative.

A GO-error occurs when the company permits a poor idea to move into development and commercialization. There are three types of product failures that can arise from this error:

(a) An absolute product failure: This loses money, and its sales do not cover variable costs.
(b) This also loses money. However, its sales cover all the variable costs and some of the fixed costs.
(c) A relative product failure: This yields a profit that is less than the firm's normal rate of return.

In summary, the major objective of the idea screening stage is to spot and drop poor ideas as early as possible. The justification for this is premised on the fact that product-development costs rise substantially at each stage. It is thus, a case of "a stitch in time saves nine".

**Stage 3: Concept Development and Testing**

The purpose of concept development and testing is to ensure that the proposed product is devoid of all kinds of problems when it eventually gets to the market.

After the elimination of all the poor product ideas at the screening stage, the surviving ideas must now be developed into product concepts. It will be necessary to distinguish between a product idea, a product concept, and a product image: A product idea is just an idea for a product that the firm can think of offering to the market. A product concept is an elaborated version of the idea expressed in meaningful consumer terms. A product image is the particular picture that consumers acquire of an actual or potential product.

Concept Development

Concept development can be illustrated with the case of a food processor, who has an idea of producing a powder to be added to milk for the purposes of increasing its nutritional level and taste. At this point, this is merely a product idea. However, customers do not buy product ideas, but product concepts.

Generally speaking, any product idea can be turned into several product concepts. Firstly, we start with the persons or group(s) of persons who are likely to benefit from the use of the product. For instance, the proposed powder can be aimed at infants, children, teenagers, middle-aged adults, or the elderly. Secondly, the primary benefits to be derived from the consumption of the powder are considered. This could be taste, nutrition, refreshment or energy. Thirdly, the primary occasion for the drink is next considered. For instance, should it be for breakfast, mid-morning, lunch, mid-afternoon, dinner or late evening?. By properly given adequate considerations to the issues raised above, a firm can develop several product concepts. For example, the following three concepts can be generated from the issues already raised:

Concept 1: An instant breakfast drink for working-class adults who want a quick nutritional breakfast without preparing a breakfast.

Concept 2: A tasty snack drinks for school children to drink as a midday refreshment
Concept 3: A health supplement for the elderly to drink in the late evening before going to bed.

Concept Testing
The purpose of concept testing is to develop a more refined estimate of market acceptance for the new product concept, or to compare competing concepts in order to determine the most appealing one (or two), or both.
Concept testing is particularly designed to obtain the reaction of potential consumers or buyers to one or more hypothetical product concepts. What is usually done is to present the product features and benefits in verbal form or explained through visual aids. Potential users are then interviewed to obtain comments about the advantages and shortcomings of each concept. Alternatively they may be asked to rate the products in various ways.

**Stage 4: Marketing-strategy Development**

What goes on at this stage is the development of a preliminary marketing-strategy. This is refined appropriately in subsequent stages.
The marketing-strategy statement often consists of three parts: In the first part, the description of the size, structure, and behavior of the target market are given. Furthermore, the planned product positioning and the sales, market share, and profit goals sought in the first few years are similarly stated.
In the second part of the marketing-strategy statement, the proposed product's planned prices, distribution strategy, as well as the marketing budget for the first year are outlined.
The descriptions of the planned long-run sales and profit goals and the marketing-mix strategy over time are presented in the third part of the marketing-strategy statement.

**Stage 5: Business Analysis**

The business attractiveness of the new-product proposal is evaluated here. Essentially, the proposal is expanded into a concrete business proposal in which management
(i) estimates sales;
(ii) estimates costs and profit projections.

These are done in order to determine whether such projections satisfy the firm's objectives.
One major purpose of estimating sales is to check if it will be high enough to return a satisfactory profit to the firm. The best approach for the sales estimation is

to examine the sales history of similar products. Additionally, a survey of market opinion should also be undertaken. From these, management should then prepare estimates of minimum and maximum sales to learn the range of risk.
After the preparation of sales forecast, management goes on to estimate the expected costs and profits of the proposal. The costs are estimated by the R&D, manufacturing, marketing and finance departments. Several techniques are then used to determine whether the proposed project meets the firm's minimum profitability standards. Among the most widely used methods are the net present-value and the payback approaches.

**Stage 6: Product Development**

If the business analysis for the proposal turns out to be favourable, the product concept moves to R&D and/or engineering, where it is developed into a physical product. It is at this stage that the "idea-on-paper" is converted into a physical product.
As would be expected, this stage calls for huge investment which is far beyond what was spent in earlier stages. This stage often determines whether the product idea can be translated into a technically and commercially feasible product. Otherwise, the firm's accumulated investment will be lost, safe for any useful information gained in the process.
While developing one or more physical versions of the product concept, the R&D department strives to find a proto-type that satisfies the following criteria:
consumers views it as possessing the key attributes described in the product-concept statement;
the proto-type performs safely under normal use and conditions;
the proto-type can be produced for the budgeted manufacturing costs.
It usually takes considerable length of time to develop a successful prototype. There is the need for the lab scientists to design the required functional characteristics. They should also know how to communicate the psychological aspects through physical cues. For example, in order to support the claim that a lawnmower is powerful, the lab people have to design a heavy frame and a fairly noisy engine!. It will also be necessary for the marketing team to work closely with the lab people so as to let them understand how consumers judge product qualities they have in mind.
When a proto-type has been developed, it must be put through rigorous functional and consumer tests. The functional tests are conducted under laboratory and field conditions to make sure that the product performs safely and effectively. The functional tests are essentially technical. They are meant to provide information on:
Product shelf life
Product wear-out rates
Problems resulting from improper usage or consumption

Potential defects that will require replacement
Appropriate maintenance schedules.

As earlier pointed out, it is also necessary to examine the product performance from the buyers' perspective. Such consumer testing can take a variety of forms, ranging from bringing consumers into a lab to test the product versions to giving them samples to use in their homes. The degree to which the new product is likely to acquire new customers rather than simply "cannibalizing" the sales of any existing products can be established. In addition, consumer product testing can provide a check on whether or not the concept has been implemented. If consumer descriptions of the product do not match the intended concept, then reformulation may be necessary.

**Stage 7: Market Testing**

If the product's functional performance is satisfactory, the product is deemed fit to be dressed up with a brand name, packaging and a preliminary marketing programme, to test it in more real-life consumer settings. The purpose of market testing is to learn how consumers and dealers react to handling, using, and repurchasing the actual product and how large the market is.
Market testing can yield valuable information about buyers, dealers, marketing programme effectiveness, market potential etc.
The amount of market testing is influenced by the investment cost and risk on one hand, and the time pressure and research cost on the other hand. Normally, high investment/risk products deserve to be market-tested so as not to make costly mistakes. Here then, the cost of the market tests will be an insignificant percentage of the cost of the project itself. In addition, high-risk products i.e those that create new-product categories or have novel features, require more market testing than modified products. However, the amount of market testing may be seriously limited if the firm is under intense pressure to introduce its brand probably because the season is just starting, or competitors are about to launch their brands. In some instances, the firm may prefer the risk of a product failure to the risk of losing distribution or market penetration on a highly successful product. Finally, the cost of market testing will affect how much is done and what kind.
There are differences in the market-testing methods between consumer and industrial products.

### 3.5.1 Consumer-Goods Market Testing

The main purpose of testing consumers is to estimate the main determinants of sales i.e trial, first repeat, adoption, and purchase frequency. Ordinarily, most firms want to find all of these at high level. However, a firm might find many consumers trying the product but not re-purchasing it, thus indicating a lack of product satisfaction. Yet, another firm might find high first-time repurchases but only to experience a rapid wear-out effect. In another instance, a firm might find high permanent adoption but low frequency of purchase because the buyers use the product only on special occasions.

Furthermore, the firm wants to understand how many and what types of dealers will handle the product, under what terms, and with what shelf-position commitments.

There are four main methods of consumer-goods market testing. These are (a) sales-wave research (b) simulated store technique (c) controlled test marketing (d) test marketing.

(a) Sales-wave research

This is an extension of the ordinary home-use testing in which consumers who initially try the product at no cost are re-offered the product, or a competitor's products, at slightly reduced prices. These consumers may be re-offered the product as many as three to five times. During these periods of offer, the firm records how many consumers selected its own product again, together with their reported level of satisfaction.

Apart from under-studying the repeat purchase of products, sales-wave research can also be used to monitor the impact of advertising exposure on repeat purchase. This is done by exposing consumers to one or more advertising concepts in rough form and then recording the effect.

Sales-wave research has been found to possess some advantages. Firstly, it enables the firm to estimate the repeat-purchase rate under conditions where consumers spend their own money and choose among competing brands. Secondly, the firm can also measure the impact of alternative advertising concepts on producing repeat purchases. Thirdly, sales-wave research can be implemented quickly, conducted under relative competitive security, and carried out without needing to develop final packaging and advertising.

This method however has two limitations: It does not indicate the trial rates that would be achieved with different sales promotion incentives, since the consumers are pre-selected to try the product. Neither does it indicate the brand's power to gain distribution and favourable shelf position from the trade.

(b) Simulated store technique

This is also variously known as "laboratory-test-markets"; "purchase laboratories" or "accelerated test-marketing". Here, about thirty to forty shoppers at a shopping centre or elsewhere are invited to a brief screening of some television commercials.

What is shown to this audience contains a number of well-known commercials and some new ones, and they usually cover a range of products. Within the period of screening, one commercial advertises the new product, but this is not singled out for attention.

The consumers are later given some small amount of money, as well as invited to a store, where they may use the money to buy any item or keep the money. The researchers record how many consumers buy the new product and competing brands. This definitely provides a measure of trial of the commercial effectiveness against competing brands. The consumers are made to reconvene in order to know the reasons for their purchases or non-purchases. Some weeks later, the same sets of consumers are re-interviewed by telephone to determine product attitudes, usage, satisfaction, and re-purchase intention and are offered another opportunity to repurchase any products.

The simulated store technique has several advantages. These include the measuring of trial rates, as well as repeat rates, advertising effectiveness, speedy results, and competitive security. The results of the exercise are often incorporated into mathematical models in order to project ultimate sales levels. The outcomes of such prediction have been found to be very accurate.

(c) Controlled test marketing

This is also called "mini-market testing". The method often requires the marketing research firm conducting the test to make some arrangement with a controlled panel of stores. Such stores must have agreed to carry new products for a given amount of money. The firm with the new product specifies the number of stores and geographical locations it wants. The marketing research firm then delivers the product to the participating stores and subsequently controls shelf location, number of facings, displays and point-of-purchase promotions, as well as pricing according to pre-specified plans. Sales that result from this arrangement can be audited both from shelf movement and from consumer diaries. In addition, the firm can test small-scale advertising in local newspapers during controlled test marketing.

This method has a special advantage since it allows the firm to test the impact of in-store factors and limited advertising on consumers' buying behaviour without involving consumers directly. A sample of consumers can be interviewed later in order to obtain their impressions of the product. Another advantage inherent in the controlled test marketing method is that the firm does not have to use its own sales force, give trade allowances, or take the time to buy into distribution.

However, this method does not provide experience in trying to sell the trade on carrying the new product. In addition, the technique also exposes the product to competitors.

(d) Test marketing

This is the costliest and the best way of testing a new consumer product. Under the method, a firm offers a product for sale in a limited geographic area that is as

representative as possible of the total market in which the product will eventually be sold. Test marketing has several distinguishing features relative to other approaches:
Test marketing lowers the risk of national failure, which could endanger channel relationships, reduce confidence, and morale of employees, and have a negative impact upon presentcustomers' images of other products.
No special benefits are offered to induce purchasing other than those that would later be available on a national basis.
The product competes with other competitive products in a real sales environment.
Any firm using test marketing usually works with an outside research firm to locate a small number of representative test cities in which the company's sales force will try to sell the trade on carrying the product and exposing it effectively on the shelves. Moreover, the firm needs to put on a frill advertising and promotions campaign in these markets as would be done in frill national marketing.
As would be expected, test marketing costs money. The actual amount to be spent however depends on the consideration given to the following:
(a) The number of cities:
It has been found that most tests use between two and six cities, with an average of four. Again, it has been further suggested that a larger number of cities should be employed if:
there is the probability of loss from going national or the maximum possible loss is very great;
there is substantial number of contending/marketing strategies or the level of uncertainty is very high;
there are wide regional differences; and
(iv) there is high chance of calculated test-market interference by competitors.

Type of cities:
Though no one city is a perfect replica of the nation as a whole, some cities often typify aggregate national or regional characteristics better than others. Such cities may be included in the study. Firms are of course; free to develop their own test-selection criteria.
1.Length of test:
Generally, the length of test markets ranges from a few months to several years. The longer the product's average re-purchase period, the longer the test period necessary to observe repeat-purchase rates. However, if competitors are rushing to the market, the period should be shortened.
2. Nature and amount of information:
The type of information to be collected has bearing with its value and cost. The following can be used to illustrate the variations in the amount of details contained in different types of information:

Warehouse shipment data shows gross inventory buying, but fails to indicate weekly sales at retail store audits will give actual retail sales and competitors' market shares but will not indicate the characteristics of the buyers of the different brands.

3. Consumer panels will show which people are buying which brands together with their loyalty and switching rates

4. Buyer surveys give in-depth information about consumer attitudes, usage, and satisfaction.

Other things that can be re-searched here include trade attitudes, retail distribution, and the effectiveness of advertising, promotion, and point-of-sale material.

Many benefits are derivable from test marketing. Firstly, it yields a more reliable forecast of future sales. For instance, if product sales fall below target levels in the test market, the firm may have to drop or modify the product.

Secondly, the method allows the pre-testing of alternative marketing plans. A different marketing mix can be employed in each of the test cities. From these, the optimum mix that results in the best profit level can be detected.

Thirdly, a firm may discover a product fault that escaped its attention in the product-development stage. In addition, the firm may discover important clues to distribution-level problems, and through this, it may gain better insight into the behaviour of different market segments. It has been observed that the main value of test marketing's does not lie in sales forecasting, but in learning about unsuspected problems and opportunities connected with the new product. Though test marketing has lots of advantages, a number of problems have been identified as limiting its effective application. These concern the problems of:

1. obtaining a set of markets that is reasonably representative of the country as a whole

translating national media plans into local equivalents

2. estimating what is going to happen in the coming year, based on what has happened in this year's competitive environment
3. competitive knowledge of appropriate test(s) and of deciding whether any local counter activities are representative of what competition will do nationally in the future.

4.extraneous and uncontrollable factors such as economic conditions and weather

### 3.5.2 Industrial-Goods Market Testing

In the past, it is usual for new industrial goods to undergo extensive product testing in the laboratories in order to measure performance, reliability, design and operating cost. With satisfactory results, many firms will commercialize the product by listing it in the catalogue and turning it over to the sales force. In modern-day business however, a large number of firms are changing to market testing as an intermediate step. Firms stand to gain substantial benefits in the process, since market testing can indicate:

the product's performance under actual operating conditions;
the key buying influences;
how different buying influences react to alternative prices and sales approaches;
the market potential; and
the best market segment

Due to certain reasons, test marketing is not typically used for industrial products. Firstly, it is too expensive to produce their samples, not to talk of putting them up for sale in a select market, just to see how well they sell. Secondly, industrial buyers will want to be sure of the availability of spare parts and after-sales services before buying durable goods. Thirdly, marketing research firms are yet to develop the test-market systems that are found in consumer markets. Hence, industrial-goods manufacturers have to use other methods that can be employed in researching the market's interest in new industrial products. Four of such methods are in use. These are (a) product-use test (b) trade shows (c) distributor and dealer display and (d) controlled or test marketing.

(a) Product-use test

This is the most common method, and it is similar to the in-house use test for consumer products. Here, the manufacturer selects some potential customers who must have agreed to use the product for a limited period. The technical team from the firm monitors how these customers use the product. The outcome of this exercise often exposes unanticipated problems of safety and servicing. It also gives the manufacturer clues about customer training and service requirements. At the end of the test, the customer is asked to express purchase intent and other reactions.

Trade shows

Another common market-test method is to introduce the new industrial product at trade shows. Trade shows usually draw a large number of buyers, who view new products in a few concentrated days. During the exposure, the manufacturer will be able to see how much interest buyers indicate in the new product, how they react to various features and terms, and how many of them actually express purchase intentions or place orders. One major disadvantage inherent in this method is that it reveals the product to competitors. Hence, the manufacturer should be ready to launch the product once it has been displayed at trade shows.

Distributor and dealer display rooms

Manufacturers can also market-test new products in distributor and dealer display rooms, where such products may be placed next to the manufacturer's other products and possibly competitors' products. This method makes it possible to obtain preference and pricing information in the normal selling atmosphere for the product. It however has some shortcomings. For instance, the customers may want to place order that cannot be met. In addition, the customers who come in might not be representative of the target market.

Controlled or test marketing

Although it was mentioned earlier that test marketing is not typically used for industrial products, some manufacturers have been found to make use of it. In this case, they produce a limited supply of the product and give it to the sales force to sell in limited geographical areas with adequate promotional support, printed catalogue sheets etc. Through this process, the firm can have a fore knowledge of what might happen under full-scale marketing and thus get well prepared for the launching.

**Stage 8: Commercialization**

At this stage, full-scale production and marketing programmes are planned, and then the product is launched. There are a number of important decisions to make before the product is finally launched.

First, the timing of the introduction should be carefully evaluated. In general, it is more appropriate to introduce the new product during peak periods if demand is seasonal. This will allow the firm to obtain a high rate of trial and early sales, helping to offset the high costs of introduction. It is also necessary to time the introduction appropriately, so that distributors will have adequate levels of inventory by the time the introductory promotional campaign starts. If the new product is being proposed to replace another product, it might be necessary to delay its introduction until the old product's stock is drawn down, through the normal sales.

Second, the firm should properly consider its geographical strategy. In particular, it should decide whether to launch the new product in a single locality, a region, several regions, the national market, or the international market. It has been observed that only few firms have the confidence, capital, and capacity to launch new products into full national distribution. They therefore tend to develop a planned market rollout over time. For smaller companies, this approach entails the selection of an attractive city with aggressive promotional campaign to enter the market. Larger companies on their part often introduce their new products into a whole region and then enter others, one at a time.

Under rollout marketing, firms have to assess the alternative markets for their new products, using such criteria as market potential, firm's local reputation, cost of filling the pipeline, quality of research data available in the particular area, influence of area on other areas, and competitive penetration. The outcome of the assessment will allow the firm to determine the prime markets and develop a geographical rollout plan.

Third, with respect to the rollout markets, the firm must target its distribution and promotion to the best prospect groups. It is expected that prime prospects should have been identified during the market testing stage. Ideally, prime prospects for new consumer products have been found to be: early adoptersheavyusersopinion leaders who talk favourably about the product

Reached at low cost.

We should note that very few groups of prospective customers possess all of the above characteristics. The best thing is for the firm to rate the various prospect groups on these features, and then target the best one. The purpose of doing this is to generate high sales as soon as possible to motivate the sales force and attract other new prospects.
Fourth, other programme decisions, with respect to price, advertising, sales promotion, and sales and distribution activities need to be developed and coordinated. These programmes are very important since they influence the sales and profit results of any new products.

## 4.0 CONCLUSION

You have learned in this unit that every company needs to develop new products. This is because new-product development shapes the company's future. Replacement products must be created to maintain or build sales. Customers want new products, and competitors will do their best to supply them. Therefore companies that fail to develop new products are putting themselves at great risk.

## 5.0 SUMMARY

Once a company has segmental the market, chosen its target customer groups, identified their needs and determined its desired market positioning, it is ready to develop and launch appropriate new products. Successful new product development requires the company to establish an effective organization for managing the development process. Eight stages are involved in the new-product development process idea generation, screening, concept development and testing, marketing strategy development, business analysis, product development, market testing, and commercialization. The purpose of each stage is to determine whether the idea should be dropped or moved to the next stage. Our subsequent unit shall focused on Quality Management as vital tool for the success of corporate development, consolidation, mergers and acquisitions exercises.

SELF-ASSESSMENT QUESTION

1. Outline and discuss the steps in the new-product development process.

## 6.0 TUTOR-MARKED ASSIGNMENT

(a) Discuss the reasons for new-product failures
(b) It has been speculated that successful new-products may even be more difficult to achieve in the future. What are the likely reasons for this ascertain?

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## UNIT 13: PRODUCT DEVELOPMENT THEORIES

### CONTENTS

1.0 Introduction
2.0 Objectives
3.0 Main Content
3.1 The Innovation and product development: Pierr Bourdieu's theory of habitus, capital and field.
3.2. New product development, desire and the fear of death.
3.3. Innovation and overcoming our fear of death
3.4. Capital, field and multiple strategies
4.0 Conclusion
5.0 Summary
6.0 Tutor-Marked Assignment
7.0 References/Further Readings

### 1.0 INTRODUCTION

This unit is based upon grounded research within small manufacturing organizationsand attempts an ontological understanding of *being innovative* rather than nautical description of
roduct development processes. We argue that theseorganizations are aware of but do not utilise the "best practice" models forproduct development and that these strategies cannot be
reduced and simplifieddown to the rational pursuit of an economic, profit maximizing goal.
They are better conceived through Bourdieu's theory of habitus, capital and field.

### 2.0 OBJECTIVES

At the end of this unit, you should be able to:
Explain the theories of product development
Explain concept of death and continuity of a product
Discuss the critique of innovation theories
Explain companies' strategies for product development.

### 3.0 MAIN CONTENT

### 3.1 INNOVATION AND PRODUCT DEVELOPMENT: PIERRE BOURDIEU'S THEORY OF HABITUS, CAPITAL AND FIELD.

How organizations innovate has been a subject of interest to academics from disciplines such
aseconomics, psychology, sociology, engineering and management for many years. This has
naturally lead to a wide and diverse literature on the subject. Despite this vast interest, or perhaps because of it, organizational innovation remains an area of considerable academic
debate(Van de Ven and Rogers, 1988; Wolfe, 1994; and Slappendel, 1996) but one that has,
accordingto Wolfe (1994), remarkably little consistency.
Van de Ven (1986) argues that innovation is both a product and process of human interaction.
Innovation, and therefore the management of innovation and new product development, is
socially and culturally based. Innovation here is seen as a process rather than an event, it has a
temporal, unfolding nature, it is not the result of some simple action that happens at a singlepoint in time and space. He argues further that innovation has a transactional nature thatsuggests it involve issues of discourse, knowledge and power between agents in some form ofsocial system (or institutional order). Finally an innovation may take many forms, one of whichis the creation of a new product. New product development (NPD) is one form of organizational innovation.

NPD research during the last decade has concentrated upon speed and time to market. Theimplicit, and at times explicit, beliefs are that: the rate of technological development iscontinually increasing; long product development times are not cost effective; markets arechanging more rapidly; market competition is increasing (see for instance, Stalk and Hout, 1990;
Vesey, 1991; Clark and Fujimoto, 1991). These beliefs lead academics, the general media andmanagement practitioners to exhort organizations to compress their product development times, in effect to adopt time compression new product development process as the “best practice” forproduct innovation.
This unit is neither a review of the various models suggested as “best practices” nor does itpresent a further practical model of a NPD process. It is instead concerned with developing an understanding of the ontology of product innovation. To paraphrase Heidegger, it considerswhat the way of being innovative is. In so doing it attempts a counter-positional critique of thephilosophy of the accepted views of new product development. It will develop a theory of newproduct development based particularly on the works of Georges Bataille and Pierre Bourdieu.

**A critique of innovation theories**

Thomas (1994) develops a sociological critique of theories of the management of innovation. Heargues against a structural determinism that he views as underpinning theories of management ofinnovation. He suggests that innovation is too often viewed as being technologically or environmentally determined.
Technological determinism here assumes innovation to be driven by an “ineluctable flow”.
Technology here constrains and determines how new products may be designed, developed and manufactured. The development of an innovation, or new product, becomes inevitable as society progresses towards some utopian future. To stand in the way would be to oppose this obviousand inevitable progress. These theories of innovation suggest why radical innovation may arise.
They do not however focus upon the process that occurs.Environmental determinism assumes that the structure of an organization’s market determineshow it produces new products. Organizational strategy and tactics, and new productdevelopment processes are chosen according to the demands of the market. An environmentaldeterministic position leads to a homogenization of organizational forms and practices within amarket or a market niche (DiMaggio and Powell 1983; Freeman and Hannan 1987). Theassumption is that organizations will become isomorphic as they mimic the practices of the mostsuccessful firm in their particular niche. Thus a successful organization in a turbulent market isone that can respond to change rapidly. This, according to Eisenhardt and Tabrizi (1995),requires them to adopt a new product development process that is equally open to adaptation.
This then becomes the accepted practice within a market as the organization’s success isrecognised and others start to mimic it.

**A post-structural critique of the best practice of NPD models**.

Technological and environmental deterministic models are based on antic methodologicalassumptions. Primary here is a belief in objectification so that a concept may be isolated, studiedand measured. Objectification however requires both a reified object *and* neutrality (Heidegger,1988). Innovation and the practice of innovation are neither. They are contextual processes thatinvolve the actions of multiple actors. To paraphrase Heidegger, innovation has two forms, it isboth a means to an end and a human activity (Heidegger, 1977), innovation therefore has astrategic nature. We will consider this further from Bourdieu’s theory of capital.
An unstated and therefore unquestioned assumption (or “doxa” in Bourdieu’s terminology[Bourdieu, 1977]) of the ontic methods is that firms use “best practice” as a rational mechanismto most efficiently meet the rules of their structurally determined world. In so doing there islittle, if any, need to question fundamentally *what it means to be innovative*. Ontological concerns disappear under the need to provide ontical

positivistic research of the processes. The possibility that non-rational and irrational forces, such as creativity, passion, desire, may affectNPD disappears under the weight of rationality. We will argue that the tension created betweenthe rational and the irrational forms the ontological being of innovation.

**3.2 New product development, desire and the fear of death.**

Georges Bataille presents a series of complex dialectical and paradoxical movements to arguethat human society is split between the profane, rational world and the sacred. This splitoccurred as a result of humanity's Fear of Death and has permitted humanity to effectivelyretreat in to the rational and profane world of work so as to distance themselves from the violence of the natural world. The profane achieves this end (albeit temporarily) and maintains itself through the imposition of rules and taboos on humans (in particular, Bataille, 1987, 1988,1990; Guerlac, 1990: 90-105). (Fear of death here becomes the limit experience of human existence. Our originary Fear of Death here is embedded with our discontinuity as human beings because each of us is individual. We are thrown into the world by a violent rupture which leaves us isolated, alone, anguished and in pain [c.f. Heidegger's notion of exteriority]. We need to extinguish these profound qualities but paradoxically they distinguish us as human.)
Bataille argues further that humans are only truly sovereign when they become self-legitimating,i.e. when they both set and act according to their own self-imposed rules. As such ouracceptance and following of social rules and taboos means that we are not truly sovereign, weare in effect Hegelian Slaves. (Bataille's philosophy here is deeply influenced by Kojève'sreading [Kojève, 1969] of Hegel's Phenomenology [Hegel, 1977]. Bataille's reading of Hegel here is somewhat idiosyncratic, departing from the more common view of Hegelian theory astranscendental dialectic towards a more Nietzschain dialectic of forever becoming. For Bataille,fascism describes the actions of a being that prevents another being from achieving sovereignty[Bataille, 1985]. According to Bourdieu [1977] such actions may be real [physical or economic]or symbolic acts of violence.) We exist within a paradoxical tension between our desire forsovereignty and our originary fear of death.
For Bataille, transgression is implicitly embedded as the other of a rule. (Rules exist to be transgressed, without it they would be an inviolable, animalistic urges.) Transgression here isnot merely the breaking of a rule however it is the means by which we transcend the profane andour originary fear of death to become sovereign. Transgression thus means that we must leavebehind the profane, rational world to become other by a leap into the void.
Batailletheoriesstates thatthis movement is accomplished when we are overcome by the ecstasy of Human Desire. (Human desire is not the longing for something that we lack. Desire as negativity, as a "lack", isanimal desire. Human desire is the desire for recognition by some other being. Furthermore wedo not possess human desire but are possessed by it. Bataille here avoids the objectification ofDesire common to humanist readings.)

Abernathy and Utterback (1978) suggest that product development is based on a cyclic motionbetween the extremes of incremental and radical innovation. Incremental product developmentand innovation seek to build on, compliment and extend existing products, resources andprocesses. As such it acts so as to develop a system without destroying it. Radical innovationdoes not build and extend what exists but seeks to overturn it. It is destructive of the skills,practices, product forms and social relationships that already exist within and betweenorganizations (Abernathy and Clark 1985; Henderson and Clark 1990).
From a Bataillean perspective incremental innovation operates in the profane and rational humanworld so as achieve a technical advance that further separates, and protects, the human worldfrom the violence of the Natural one. It achieves continuity, and allows progression whilsmaintaining, and further reifying, existing social systems. Incremental innovators here "step back" from the void, preferring the safer ground of the known world. They do so however at thecost of remaining as slaves in a state of servitude, only radical innovation holds out thepossibility of sovereignty.

Radical innovation destructively transgresses existing rules and taboos to establish itself beyond a high degree of risk for the innovator. There can never be a guarantee that the "cost" of transgression will be paid or indeed that the innovator survives the risk of transgression. Radical innovation carries with it the possibility of complete destruction for the innovator. We can notunderstand this willingness to risk all within a profane, rational framework. The existence ofradical innovation demands a theory of a Batailleantransgressive desire. The fundamental,ontological question here is, "Why do some step back whilst others risk all, including death, toinnovate?" We will now attempt to answer this question below.

### 3.3 Innovation and overcoming our fear of death

To produce a radical innovation implies that the limit experience, the human fear of death, is atleast temporally, overcome. An appreciation of Bataille's philosophy suggests that this may beachieved through human desire for recognition. Radical innovation here stems from a desire tobe recognised as innovators by those whom we respect. The desire is not just to be innovativebut to be seen as innovative, a desire to be recognised as sovereign. The corollary suggests thatincremental innovation and more so the failure to innovate is followed where this desire isinsufficient to overcome our fear of death or where we believe ourselves to already be sovereign.

The desire for sovereignty however may be insufficient by itself if the innovator lacks the ability to achieve sovereignty here is suggestive of a power relationship. Power here has tobe viewed in the Foucaultian sense because it allows an innovator to transgress even when theyare in a dominated position within a social system (Foucault 1980). Seen from this perspective,the attempt by an agent to impose rules and taboos which maintains their dominant position in asociety attains the status of symbolic violation and annihilation

against the Slave. The conceptof a “best practice” form of innovation or product development here becomes particularlypernicious because they appear as facts legitimated by an independent authority. It maintainsand reifies practices and positions within an industry, reduces the scope for transgression andchange and acts as a barrier for a dominated company to achieve sovereignty.
In order to achieve radical innovation, the innovator needs to be open to immersion in, orpossession by, Human Desire. This becomes increasingly more likely as she places the limitexperience under increasing tension by transgressing the rules and taboos of the profane.

We will now present empirical evidence drawn from two SMEs to substantiate our Batailleaninfluenced ontology of innovation. These organizations have similar structural characteristics(size, market type, age, turnover and family owned and managed). Company A has won numerous awards for innovative products whilst Company B has been described by its customersand itself as “non-innovative”.
The evidence below is a distillation of over 20 hours of semistructuredcompanies.

**Company A-a radical innovator**

Its present managing director (MD) formed this organization after she divorced her first husband some 21 years ago. The company employs the MD’s sons in several senior roles. It operates inthe same market and is in direct competition with the MD’s ex-husband’s company. Her ex-husband’s company dominates what is described to be a highly competitive market and has established the de-facto product standards for it. The MD believes that market, and economic, advantage comes not from establishing and maintaining these standards but by achieving logistical advantages. According to the MD, her company has not pursued a strategy focused on logistics, preferring to concentrate on radical product development as a means to challenge thede-facto standards. She does believe that her company should be run for economic maximizing
reasons.

**Company B – “non-innovative”**

This company was set up some twenty years ago. It passed to the present MD on the death ofone of the founders, the present MD’s father. The MD wished to pass the company on to hisown children in the future. During the interviews the product and market was described as static,a viewpoint that came to be contested because of major changes that occurred in the market.
(Changes included increased competition, a smaller market size and new demands by customersfor lower prices, increased efficiencies, rapid product developments and multiple rather thansingle source supply contracts.) The organization believes that it “serves” its customers withwhom it has established a relationship and understanding. It

believes that these relationshipsform the basis of its market advantages, advantages that lead to “sufficient” rather than maximalturnover and profit.

**Death and continuity**

Company A

During the interviews the MD of Company A made clear that she did not intend her sons inheritthe company even though she describes the company as a family business (*“this is a lifestyle type business, it is a family business. Furthermore, most people out on the shop floor know thefamily. It’s got a history that tends to reinforce the family aspect”*). The family here takes on arole in the present, as a social system rather than as an historic lineage whereby the childreninherit capital from the parents. Her concern was with the present, as an arena to contest her ex-husbands company’s market dominance. She believes that radical product innovation acts as ameans whereby her company may fundamentally change the de-facto market standards and sobecomes the market leader. Her company focuses on this to the exclusion of a more rational,economic pursuit of improving its logistics.

The MD of this company does not accept the economic hegemonic “logic” of modern society whereby men assume the role of economic provider (Beck and Beck-Gernsheim, 1995). Herinitial act of forming Company A was to gain economic independence from her ex-partner, to become sovereign in her own right. (It is apposite to note that she has rejected her gendered role in society for many years. She rejected a place at a “ladies finishing school” at the age of 18 in favor of a University education and studied for her B.Sc. in Engineering – very much a male bastion - some 30-40 years ago. So from a relatively early age she followed a path of questioning, breaking, transgressing the taboos and rules of society.)

**Company B**

Company B was started by its founders who then bequeathed the organization to their ownfamily:

Furthermore continuity here becomes important. The present MD, a son of one of the founders,inherited the organization. The MD wants his own children to inherit the company. The senseof continuity and history here is particularly strong:

This sense of continuity becomes more profound because it is enmeshed with the company beliefthat it operates in a stable market, one where long term relationships are important. These allowthe organization to know its customers, suppliers and competitors and be known to them:

When faced with the potential of an indeterminate market that suddenly demands change (and holds the potential of death) it expresses a marked degree of consternation; it does notunderstand *why* its customers are undermining the stable master-slave relationship.

### 3.4 Capital, field and multiple strategies

It is clear that Company A is willing to risk the limit experience in order to be sovereign whilst Company B attempts to defray death even though the cost is its own slavery. In order to be successful however, Company A requires sufficient total capital to become the object of the *other’s*desire. In order to achieve this the act of innovating is not sufficient – the organizationmust become the object of the other’s desire; it must achieve sufficient status in fields associatedwith “being innovative”.
Table 1 situates these two companies within various fields that they view as important to boththeir industry and innovation. (The economic capital of both these companies is similar, inBourdieuean terms both occupy dominated positions within the economic field. Table 1excludes the economic capital of these two companies both because of their overall similarityand so as to reduce the complexity of the diagram. It considers only the forms of capital thatmight be thought of symbolically as cultural capital.) These fields are the characteristics thatthese companies associate with being an innovative company.

Table 3- Innovation, Capital and Field

| Position / Field | Dominant | | Dominated |
|---|---|---|---|
| | Dominant | Dominated | |
| Education (General educational standard of senior staff.) | Company A (Degree or higher.) | | Company B (HNC/ONC.) |

| Technical knowledge for industry | Company A (Good knowledge of technology outside own area.) | | Company B (Good knowledge only of own specialist area.) |
|---|---|---|---|
| Status as innovator | Company A (Wins awards for innovation.) | | Company B. |
| Status in industry | | Company A (Independent SME.) | Company B (Low tier Supply chain SME.) |

It is important to remember that human desire is the desire for recognition – a human desire for innovation is the desire to be recognized innovative. Being innovative should not be conflated with the possession of a sufficient volume of capital, capital acts as a resource to enable action itdoes not determine here the propensity for action. (It is apposite to note that there are many conflicting accounts in the academic literature regarding whether or not an organization's access to finance leads to increased levels of radical innovation. Such arguments confuse a resourcewith a propensity to act.) The propensity for radical innovation is held within the organization'transgression of its fear of death as it becomes consumed by Human Desire.

An innovative company here has skilled, educated staff knowledgeable about technology within their own and other industries. It will have gained external recognition for innovation in theform of prizes or awards. It will finally be able to develop its own designs and therefore hassome degree of independent status in its industrial market.
Bourdieu suggests that action is directed towards improving our relative positions withinmultiple fields. Actors do not attempt to gain positional advantage in a single area but try toimprove or maintain their positions in many related areas by accumulating appropriate capital.
(The form or type of a capital is dependent on its associated field. Educational capital is theactor's educational qualifications. Capital can however be transferred between fields

becausethey are all related to a dominant form of capital – economic capital. [Bourdieu, 1984])
However, our propensity to invest in a field is linked to our existing capital as this determinesboth the required future investment *and* our likelihood of success. Success is more likely if oneoccupies a position within the dominant domain. (Bourdieu [1984] argues that it is easier tomove from a dominated sub-position within the dominated sector than to move from thedominated to dominant sector.)
It is clear from this simple comparison that Company A possesses more capital, in Bourdieu'ssense, than Company B. Company A is better able to contest and improve its relative standings in these fields than Company B; it is quite simply more able to achieve a dominant position inthese various fields. Company A can therefore achieve sovereignty through radical innovationby pursuing a complex, multiple strategy of investing in the diverse fields associated withinnovating. It has both the resources to achieve this and, as we have shown above, thepropensity for radical innovation because it wishes to gain sovereignty.

## 4.0 CONCLUSION

Innovation is often theorized according to an ontical methodology whereby innovation is reducedto a reified object. Ontical methodology here often results in concepts of "best practice "innovation processes. "Best practice" here is however both context dependant and non-neutral innature. The consequence of this non-neutrality is however often ignored by researchers. "Best practice" theories here reduce innovation to someform of economic utility supportive of the economic hegemony. The potential that actors may be acting according to non-economic rationales is lost.Ontical methodology furthermore is not appropriate for considering innovation as ontological.
An ontological theory of innovation suggests that the being of innovation is associated with thelimit experience and sovereignty. Radical innovation here is a Bataillean Desire for sovereignty.
In order to achieve sovereignty however requires both the desire to transgress and the means toachieve it. Desire here is the desire for recognition and therefore requires the transgressiveinnovator in a move to become the object of the *other's* desire; the innovator must not only beinnovative but recognized *as* innovative. The innovator is placed in a complex and multipleseries of strategic moves whereby they attempt to acquire sufficient capital in the fieldsassociated with innovation. Radical innovation is thus dependent on multiple strategic actionsrather than a simple economic one.

## 5.0 SUMMARY

New product success still remains the critical challenge for companies. Many companies are aware of the major role new products must play in their future and quest for prosperity: companies are constantly searching for ways to revitalize, restructure and redesign their NPD practices and processes for better results. This unit had considered companies strategies for new product innovation, our analysis also considered the deathand continuity of a new product. We shall consider TQM in the subsequent unit.

## 6.0 TUTOR — MARKED ASSIGNMENT

(a) Discuss the critique of innovation theories
(b) Thesummarise the differences between a radical innovator and non-innovative.
(c) Explain the post-structural critique of the best practice NPD models.

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## UNIT 14: QUALITY

**CONTENT**

1.0 Introduction
2.0 Objectives
3.0 Main Content
3.1 The Meaning of Quality
3.2 Quality Control
3.3 Steps in Quality Control Programme
3.4 Objectives of Quality Control
3.5 Steps in Quality Control Process
3.6 Advantages of Quality Control
4.0 Conclusion
5.0 Summary
6.0 Tutor-Marked Assignment
7.0 References/Further Readings

### 1.0 INTRODUCTION

This unit introduces you to fundamental of Quality; every manufacturing organisation is concerned with the quality of its product. While it is important that quantity requirements be satisfied and production schedules met, it is equally important that the finished product meet established specifications. Because,customer's satisfaction is derived from quality products and services. Stiff competition at national and international level and consumer's awareness require production of quality goods and services for survival and growth of the company. Quality and productivity are more likely to bring prosperity into the country and improve quality of work life.
However, the management looks to achieve customer satisfaction by running its business at the desired economic level. Both these can be attained by properly

integrating quality development, quality maintenance and quality improvement of die product. The integration of these three aspects of a product can be achieved through a sound quality control system.
Quality is a relative term and it is generally used with reference to die end use of the product. For example, a gear used in sugarcane juice extracting machine may not possess good surface finish, tolerance and accuracy as compared with the gear used in the head stock of a lathe, still it may be considered of good quality if it works satisfactorily in die juice extracting machine. The quality is thus defined as die fitness for use/purpose at die most economical level.

## 2.0 OBJECTIVES

After studying this unit, you should be able to:

- Define the term "Quality".
- Describe the various classifications of "Quality" products.
- Explain "Quality Control.
- AnalyseObjectives of Quality Control.
- Discuss the benefits of quality control.
- Describe the Cost of Quality.

## 3.0 MAIN CONTENT

### 3.1 THE MEANING OF QUALITY

The word "Quality" has variety of meanings :-
1. Fitness for purpose: The component is said to possess good quality, if it works well in the equipment for which it is meant. Quality is thus defined as fitness for purpose.
2. Conformance to requirements: Quality is die ability of the material/component to perform satisfactorily in an application for which it is intended by die user. Quality of a product, thus, means conformance to requirements. Customer needs have to be assessed and translated into specifications depending upon die characteristics required for specific application. Just as every human has his own characteristics every application has its own characteristics.
3. Grade: Quality is a distinguishing feature or grade of the product in appearance, performance, life, reliability, taste, odor, maintainability etc. This is generally called as quality characteristics.
4. Degree of preference: Quality is the degree to which a specified product is preferred over competing products of equivalent grade, based on comparative test by customers, normally called as customer's preference.
5. Degree of excellence: Quality is a measure of degree of general excellence of the product.

6. Measure of fulfillment of promises: The quality of a product is a measure of fulfillment of the promises made to the customers.

The quality of a product must have the following features;

1. Suitability: For specific application.
2. Reliability: It should give efficient and consistent performance.
3. Durability: It should have desired life.
4. Safety: Safe and foolproof workability.
5. Affordability: It should be economical.
6. Maintainability: It should be easy to maintain.
7. Aesthetic look: It should look attractive.
8. Satisfaction to customers: It should satisfy the customers' requirements.
9. Economical: It should have reasonable price.
10. Versatility: It should serve number of purposes.

A product can be said to possess good quality if all the above requirements are properly balanced while designing and manufacturing it.

SELF ASSESSMENT EXERCISE 1

1. Give four (4) definitions of quality.

**3.2 Quality Control**

Control can be defined as "a process by means of which we observe the actual performance and compare it with some standard".

If there is a deviation between the observed performance and the standard performance then it is necessary to take corrective action.

The term "Quality Control" has variety of meanings:

1. Quality control is the process through which we measure the actual quality performance, compare it with the standards and take corrective action if there is a deviation.
2. It is a systematic control of various factors that affect the quality of the product. It depends on: Material, Tools, Machines, type of labour, working conditions, measuring instruments, etc.
3. Quality control can be defined as the entire collection of activities which ensures that the operation will produce the optimum quality products at minimum cost.
4. It can also be defined as the tools, devices or skills through which quality activities are carried out.

5. It is the name of the department which devotes itself full time to quality functions.
6. The procedure for meeting the quality goals is termed as quality control.
7. It is a system, plan or method of approach to the solution of quality problems.
Total Quality control is "An effective system for integrating the quality development, quality maintenance and quality improvement efforts of the various groups in anorganization, so as to enable production and services at the most economical levels which allow full customer satisfaction."

## 3.3 Steps In Quality Control Programme

1. Formulate quality policy.
2. Work out details of product requirements, set the standards (specifications) on the basis of customers preference, cost and profit.
3. Select inspection plan and set up procedure for checking.
4. Detect deviations from set standards or specifications.
5. Take corrective action through proper authority and make necessary changes to achieve standards.
6. Decide on salvage method i.e. to decide how the defective parts are disposed of, entire scrap or rework.
7. Co-ordination of quality problems.
8. Developing quality consciousness in the organization. Quality control is not a function of any single department or a person. It is the primary responsibility of any supervisor to turn out work of acceptable quality.

Quality control is one aspect of production planning and control. It is basically concerned with the quality production through regular inspection technique. Quality is a combination of characteristics pertaining to the manufacture of the product and control is the correction in the quality of the product, when the deviations in the product are more than expected. A good quality item is one which conforms to some standard specifications. These specifications are determined by the expectations of consumers and also by the availability and costs of processes and materials.
To most people, quality is variable. It is subjectively judged because it deals with the relative goodness of a product. When a buyer boasts that his house or car is the best, it implies high quality. Quality is thus subjective and vaguely measurable.
In the words of Broom,
"Subjective quality refers to degree of goodness of a product and objectively it consists of a set of measurable characteristics for which standard dimensions together with small, allowable departures, up and down, may be prescribed."
All manufacturing processes face a basic difficulty. It is physically impossible to make all items or units exactly alike. There is always variability in the product. With precision manufacturing, the variability may be difficult to see but

nevertheless it is there. When variability becomes obvious it results in scraps, re-work and losses, thus adding to the costs.

## 3.4 Objectives of Quality Control

1. Establishment of quality standard: The main objective of quality control is the economical production of a high quality product at the quality level the customer wants. It is basically for eliminating variations in production and in order to have uniformity in production.
2.Locating quality deviations: It is necessary to analyze the trend and extent of quality deviations in a manufacturing process. Such deviations should be explained by statistical techniques when they cannot be attributed to the element of chance.
3.Evaluating methods and processes of production: By evaluating methods and processes of production, quality control helps to take corrective measures to maintain the quality of the product during the process of manufacture.
4.Quick sale of quality goods: Quality control accelerates the sale of the goods by supplying only the quality goods in the market. Consumers also support quality goods.
5.Production of standard quality goods: Quality control aims at manufacturing standard quality products and avoids the production of inferior quality goods. Such standard quality goods give satisfaction to consumers and also create goodwill in the market.
6.Improvement in quality: One objective of quality control is to find out high quality standards and to make constant efforts to reach those standards. Quality control aims at creating quality consciousness at all levels in the Organisation.

## 3.5 Steps in Quality Control Process

1.Devising control over raw materials: The quality of the finished product is determined mostly by the quality of raw materials. It calls for close connection between the raw material purchase department of the company and the vendors. As and when necessary, a resident inspector may be deputed by the Quality Control Department in the vendor's place to see that only goods in accordance with specifications are supplied. It is advisable to re-inspect the raw materials before putting them to actual use.
2.Fixing standards and specifications: In order to make any scheme of quality control successful, it is essential to predetermine standards and specifications. The practice should be to provide quality instructions in the form of drawings, showing shapes, dimensions and specifications describing color, strength, thickness, chemical composition, etc.
3.Exercising control over production operations: In order to execute efficient practices, the technical expert of the Quality Control Department must investigate,

from time to time, the operating methods. Such investigation helps to eliminate all possible variables.
4.Locating inspection points: When the points at which defects occur are wrongly located or located with delay, it hinders quality control. Therefore there should first inspection of the raw materials at the vendor's places, then at the company's plant, then at the various points during the process of production and finally at the time of packing. The defects are likely to occur at these points. The finished goods can be cleared after obtaining 'O.K.' or 'All Correct' from the Quality Control Department.
5.Maintaining quality of equipments: The final quality of the products is conditioned by the quality of the equipments and other devices used. The Quality Control Department is responsible for testing the equipment used in inspection such as gauges, which measure dimensions, electronic devices, magnetic devices and industrial radio graphical instruments.
6.Maintaining records: The Quality Control Department is responsible for maintaining all records relating to quality inspection and control and the number rejected.

## 3.6 Advantages of Quality Control

Quality control is important as it offers certain advantages to the manufacturer. Such advantages are: stability to sale, goodwill in the market, ability to face market competition effectively, reduction in production costs, and elimination of wastage due to rejections and uniformity in production. These benefits are important for sales promotion and profit maximization. Manufacturers now give special attention to quality control techniques for long term benefits. Attention is given to research and development activities for this purpose. Even foreign collaborations are made for raising the quality standards of products manufactured. In brief, quality control is a matter of great importance in production management.
The benefits of quality control to consumers are:
1. Availability of standard quality and reliable goods, proper reward for the price paid
2. Safety to life and health
3. Better standard of living and protection against substitution or adulteration and quick shopping of goods. Consumers always purchase standard quality goods even by paying a little higher price as they get full satisfaction over a long period from quality goods. Consumers, particularly educated consumers, support quality products as they know the benefits available from such standard quality products. This suggests the importance of quality control from the point of view of consumers.

The importance of quality control is, now, accepted even at the global level. Consumers now insist for superior quality goods. Expenditure on quality control is an investment for more sale and satisfaction to consumers. Quality control is a must for export promotion. Companies can capture foreign markets only by manufacturing superior quality goods at reasonable cost of production. Japan is a leading world exporter. This is mainly due to superior quality of goods manufactured in Japan. Governments in many countries support quality control measures. They provide all possible help for maintaining superior quality of goods. Restrictions are also imposed on the manufacturing of cheap goods. Even associations of manufacturers and traders support quality control measures. This suggests the importance of quality control in business.

## SELF ASSESSMENT EXERCISE 2

1. What is the importance of Quality control?
2. What are the factors to consider in the cost of carrying out company quality program also known as "Cost of Quality

## SELF ASSESSMENT EXERCISE 3

1. What are the costs involved in quality control?

## 4.0 CONCLUSION

The quality depends on die perception of a person in a given situation. The situation can be user-oriented, cost-oriented or supplier-oriented. Since, die item is manufactured for me use of die customer, die requirements of die customer dictates die quality of die product. Quality is to be planned, achieved, controlled and improved continuously.

## 5.0 SUMMARY

In this unit we have gave detail analysis on meaning of Quality, Quality control and costs of quality in organization. We shall further this explanation in the next unit by considering Total Quality Management as corporate development tools.

## 6.0 TUTOR-MARKED ASSIGNMENT

(a) Discuss Advantages of Quality Control
(b) The word "Quality" has variety of meanings? Give three meaning in your own word.

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## UNIT 15: TOTAL QUALITYMANAGEMENT

## CONTENT

1.0 Introduction
2.0 Objectives
3.0 Main Content
3.1 Quality and Total Quality Management
3.2 Quality and Its Associated Cost
3.3 Total Quality Management (TQM)
3.4 Criticism of TQM
4.0 Conclusion
5.0 Summary
6.0 Tutor-Marked Assignment
7.0 References/Further Readings

## 1.0 INTRODUCTION

In this unit we are going to look at the concept of Quality and Total Quality Management.

## 2.0 OBJECTIVES

At the end of this unit, you should be able to:
· identify the costs associated with Quality
· explain the concept “Total Quality Management”
· list the criticisms against the concept TQM.

## 3.0 MAIN CONTENT

### 3.1 Quality and Total Quality Management

### 3.2 Quality and Its Associated Cost

The Oxford English mini dictionary defines quality as a degree of excellence, a characteristic distinctive attribute of a person or thing.
Generally, the notion of quality is inherent in every organisation.Mission statements of most organisation have the phrase “qualityservice” or “quality products” boldly inscribed. According to Needle (1999), the traditional view of a quality product isthat it conforms to specifications.
Today, however, quality is seen in the perspective of the customer vis-a-visvalue for money, reputation, appearance, safety, ease of use,customer support and behaviour of staff with whom the customer hascontact.Quality has costs associated with it.
These are:
a. Failure Costs: This refers to those costs incurred when goods arefound to be faulty. The cost includes those incurred by thecompany in scrap or replacement.
b. Appraisal Costs: Are those costs involved in the installation andoperation of a quality control system. It includes the time takento complete paper work systems and the employment of staffwith specific responsibility for quality control.
c. Prevention Costs: This entails the establishment of mechanismswhich build quality procedures in all operations.

### 3.3 Total Quality Management (TQM)

TQM emerged from the work in statistical quality control at the WesternElectric Hawthorne plant in the 1930s.

It is a strategic approach to quality which embraces the entireorganisation. The main features of TQM are:

- It is a top-down management philosophy that focuses on the needs ofcustomer.
- It comprises a quality plan which offers a structured, disciplinedapproach to quality.
- it is culturally based, with involvement as a core philosophy.
- by focusing on the costs of poor quality, it saves money.
- it encompasses the notion of continuous improvement and as such, itis essentially long-term.

### 3.4 Criticism of TQM

TQM has been subjected to a series of criticism principal among them are:

- that the importance of TQM has been over-emphasised to thedetriment of the effects of technology, market dominance and theinfluence of the state and the control of critical raw materials.
- that TQM may be feasible in some organisations but greatly limitedin some others.
- that the assumption that total quality is relatively easy to come by ismisguided.
- that the feature of excellence may not be directly linked tocompanies that adopt the concept of TQM alone.
- that a strong commitment to TQM may lead to resistance to change.
- that the not-so excellent companies may exhibit the same attributes.
- that it is difficult to prove a relationship between TQM and companyperformance.

**SELF ASSESSMENT EXERCISE**

1. What is Quality and what are its associated costs?

## 4.0 CONCLUSION

TQM is a holistic approach to Quality Management. Top managementdetermines the quality priorities and establishes the systems for itsadministration.

## 5.0 SUMMARY

TQM is a strategic approach to quality which affects the entireorganisation. It incorporates certain essential features and has itsassociated cost.

## 6.0 TUTOR-MARKED ASSIGNMENT

1. What are the essential features of TQM? Briefly explain each.

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