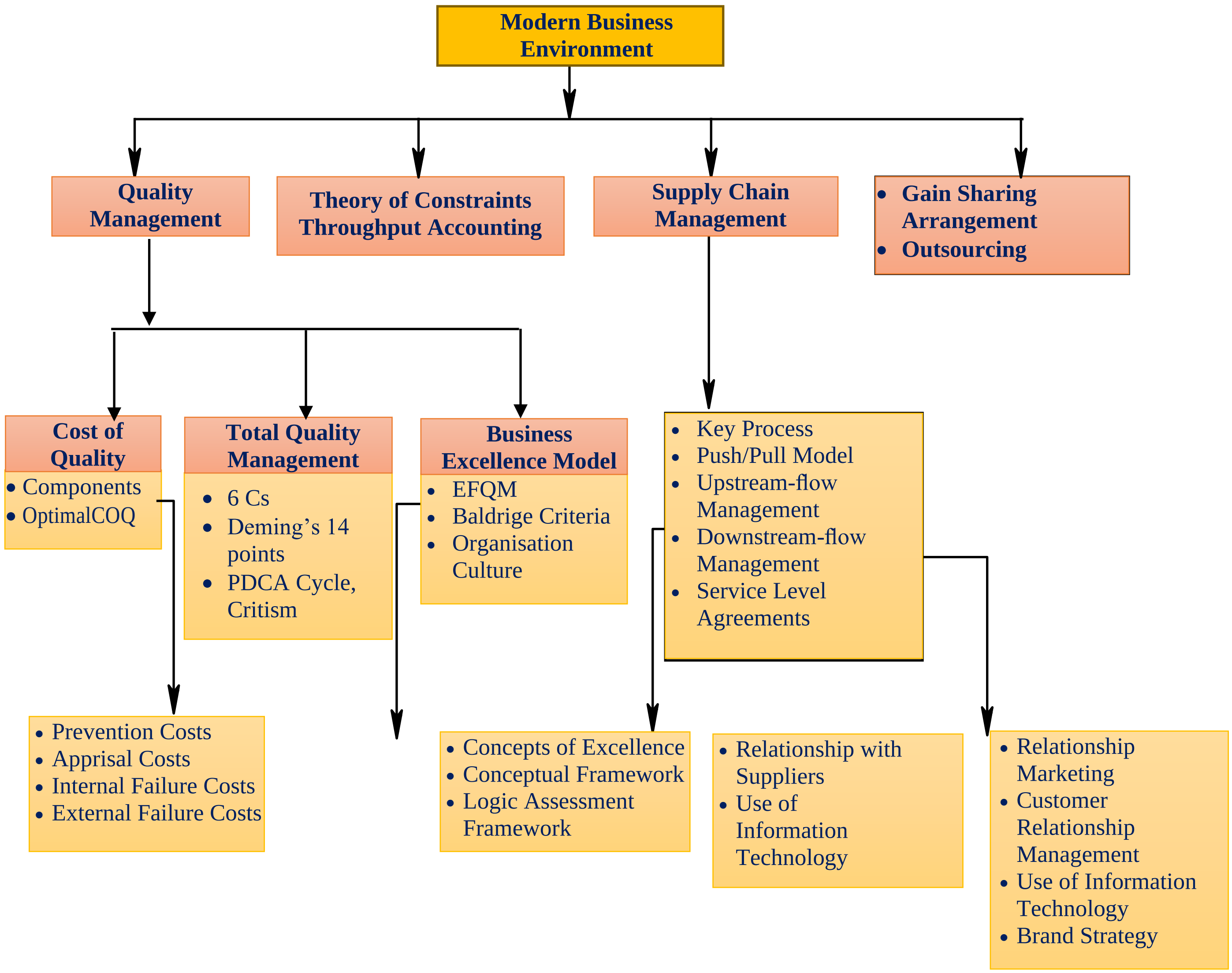
Modern Business Environment

CHAPTER-2

CHAPTER OVERVIEW

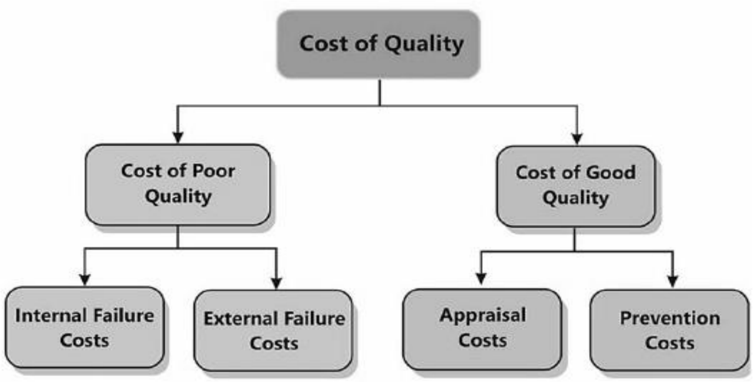


Modern Business Environment

Today's business environment is that of a *buyer's market*. This trend is the result of international transitions and macroeconomic, technological, political, and social changes. The challenge for businesses today is to satisfy their customers through the exceptional performance of their processes.

COST OF QUALITY (COQ)

Mr. Philip B. Crosby in his book Quality is Free referred to the COQ costs in two broad categories namely 'Price of Conformance' and 'Price of Non-conformance'. These two can be bifurcated further in to prevention & appraisal costs and internal & external failure costs. Hence, COQ is often referred as PAF (Prevention, appraisal & failure) model. In other words, 'Price of Conformance' is known as 'Cost of Good quality' and 'Price of Non-conformance' is often termed as 'Cost of Poor Quality'.



Prevention Costs

The costs incurred for preventing the poor quality of products and services may be termed as

Prevention Cost. These costs are incurred to avoid quality problems. They are planned and incurred before actual operation and are associated with the design, implementation, and maintenance of the quality management system. Prevention costs try to keep failure and appraisal cost to a minimum.

Examples include the costs for:

- Supplier evaluation
- Staff Training
- Extra Maintenance Cost

Appraisal Costs

The need of control in product and services to ensure high quality level in all stages, conformance to quality standards and performance requirements is Appraisal Costs. These are costs associated with measuring and monitoring activities related to quality. Appraisal Cost incurred to determine the degree of conformance to quality requirements (measuring, evaluating or auditing). They are associated with the supplier's and customer's evaluation of purchased materials, processes, products and services to ensure that they are as per the specifications. They could include:

Examples include the costs for:

- Inspection of man
- Material/Machine

Internal failure cost

Internal Failure Cost associated with defects found before the customer receives the product or service. Internal failure costs are incurred to remedy defects discovered before the product or service is delivered to the customer. These costs occur when the product is not as per design quality standards and they are detected before they are transferred to the customer. These are costs that are caused by products or services not conforming to requirements or customer/user needs and are found before delivery of products and services to external customers. Deficiencies are caused both by errors in products and inefficiencies in processes. They could include:

- **Scrap**
- **Rework**
- **Downgrading**

External Failure Costs

External failure costs are incurred to medicate defects discovered by customers. These costs occur when products or services that fail to reach design quality standards are not detected until after transfer to the customer. After the product or service is delivered and then the defects is found then it is an external failure. Further external failure costs are costs that are caused by deficiencies found after delivery of products and services to external customers, which lead to customer dissatisfaction. They could include:

- Repairing
- Warranties
- Specification Loss
- Product Liabclaim.

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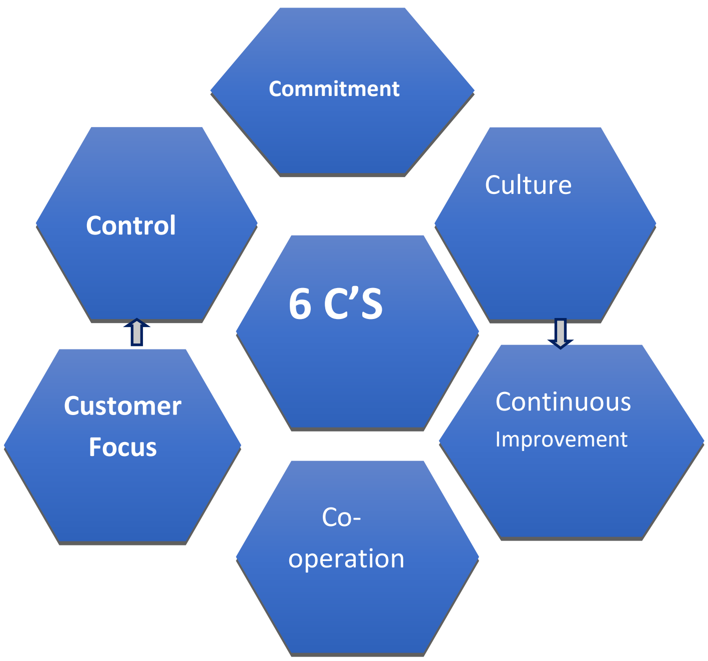
Six C's of TQM

The Six Cs for successful implementation of a Total Quality Management (TQM) process is depicted as follows:



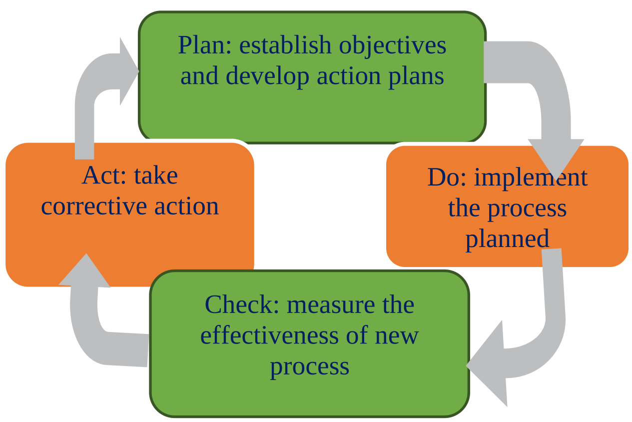
- **Commitment:** If a TQM culture is to be developed, so that quality improvement becomes a normal part of everyone' job, a clear commitment, from the top must be provided. Without this all else fails. It is not sufficient to delegate "Quality" issues to a single person since this will not provide an environment of changing attitudes and breaking down the barriers to quality improvement. Such expectations must be made clear. Together with the support and training necessary to their achievement.
- **Culture:** Training lies at the center of effecting a change in culture and attitudes, Management accountants, too often associate "creativity' with "creative accounting" and associated negative perceptions. This must be changed to encourage individual contributions and to make "quality" a normal part of everyone's job.
- **Continuous Improvement:** Recognition that TQM is a "process" not a "programme" necessitates that we are committed in the long term to the never-ending search for ways to do the job better. There will always be room for improvement, however small.
- **Co-operation:** The application of Total Employee Involvement (TEI) principles is paramount. The on-the-job experience of all employees musts be fully utilized and their involvement and co-operation sought in the

development of improvement strategies and associated performance measures.

- **Customer Focus:** The needs of the customer are the major driving thrust; not just the external customer (in receipt of the final product or service) but the internal customer's (colleagues who receive and supply goods, services or information). Perfect service with zero defects in all that is acceptable at either internal or external levels. Too frequently ,in practice, TQM implementations focus entirely on the external customers to the exclusion of internal relationship; they will not survive in the short term unless they foster the mutual respect necessary to preserve morale and employee participation.
- **Control:**Documentation, procedures and awareness of current best practice are essential if TQM implementation is to function appropriately. The need for control mechanisms is frequently overlooked, in practice, in the euphoria of customer service and employee empowerment. Unless procedures are in place improvements cannot be monitored and measured nor deficiencies corrected.
- **Difficulties**will undoubtedly be experienced in the implementation of quality improvement and it is worthwhile expounding procedure that might be adopted to minimize them in detail.

The Plan–Do–Check –Act (PDCA) Cycle

Deming developed the Plan – Do – Check – Act cycle. PDCA Cycle describes the activities a company needs to perform in order to incorporate continuous improvement in its operation. This cycle, is also referred to as the Deming wheel. The circular nature of this cycle shows that continuous improvement is a never-ending process.



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PRINCIPLES OF DEMING (TQM) ABOUT W. EWARDS DEMING

Summary (Just to Learn)

Store → **Production** → **Inspection (Finished Goods)**

Store	Production	Inspection (Finished Goods)
1:- Move towards Single Supplier (Multiple supplier mean Variation between feed stock)	2:- Institute training on Job:- If Peoples are not trained, they will not do all work in same way (Variation)	12:- Cease Dependency on Inspection (if Variation is Reduced, No inspection is Required)
	3:- Institute education (self improvement)	13:- Improve constantly & Forever :Reduce variations /Wastage (Cost Reduction)
	4:- Drive out fear	14:- Adopt new Philosophy (Innovation/reject tradition)
	5:- Institute, Leadership not super vision	
	6:- Permit Pride of Workman ship (Confidence)	
	7:- Eliminate slogans/ Exhortations	
	8:- Transformation is everyone job (Every employee will get work according to his quality/change)	
	9:- Create Constancy for Improvement (Short term replace with Long Term)	
	10:- Break Down Barriers between department (each can shares its idea openly)	
	11:- Eliminate MBO (Production Target: Encourage Poor Delivery	

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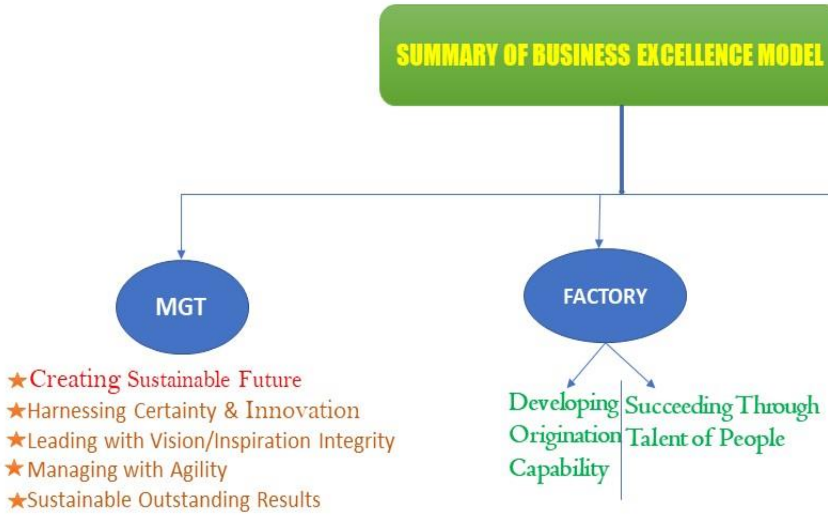
The Business Excellence Model



Business Excellence (BE) is a philosophy for developing and strengthening the management systems and processes of an organization to improve performance and create value for stakeholders. The essence of this approach is to develop quality management principles that increase the overall efficiency of the operation, minimize waste in the production of goods and services, and help to increase employee loyalty as a means of maintaining high standards throughout the business by achieving excellence in everything that an organization does (including leadership, strategy, customer focus, information management, people and processes).

Business excellence principles emerged because of development of quality drive into traditional business management. Business excellence considers various management thoughts as core concepts and structures quality management in a manner that can be adapted by any enterprise. Several business excellence models exist world-wide. While variations exist, these models are all remarkably similar. The most common include:

- EFQM Excellence Model
- Baldrige Criteria for Performance Excellence
- Singapore BE Framework
- Japan Quality Award Model
- Australian Business Excellence Framework

EFQM Excellence Model

The EFQM model is a practical, non -prescriptive tool that enables organizations to understand the cause and effect relationships between what their organisation does and the results it achieves. The EFQM model presents set of three integrated components:

- The Fundamental, concepts of excellence
- The Criteria, conceptual framework

- The RADAR, logic assessment framework

Baldrige Criteria for performance Excellence

This model provides the foundation for most of the business excellence models adopted around the world. The framework is build round the seven categories i.e.,

- Leadership,
- Strategic planning,
- Customer and market focus,
- Measurement analysis and knowledge management,
- Workforce,
- Process management and
- Business results.

Business Excellence Model and Organizational Culture

- Business Excellence approach focuses on strengthening the internal function and communication, looks towards the cultivation of strong ties with consumers and can be incorporated into the culture.
- Excellence cannot be attained if the staffs are forced to conform to certain norms. They have to be critically managed and motivated. A wisdom is required to be developed among employees that by pursuing the goal of their organization they are meeting their own objectives. Employees feel accredit when they are considered important elements in pursuit of excellence as they learn new skills.

Business Excellenceis a philosophy for developing and strengthening the management system and processes of an organization to import stakeholders. Stakeholders in an organization are not limited to shareholders (business) alone. They include also customers, employees (people) and society. What an organization does impact all the stakeholders in different ways, yet they are all interlinked to each other. Customers needs are of paramount importance to companies. Yet given uncertain conditions, shareholders demand challenging return on their investments. Employees need more from their company than just their pay-check. They want the company to enable to grow their knowledge and experience that can improve their career growth. Society expects companies to operate ethically and for the overall betterment of the society and environment.

For several years business have been operating under challenging circumstances. For example, Landline phones have been entirely replaced by mobile phones. Television programs can be watched seamlessly on internet enabled mobile phones. Not just this today’s smart phones have computing capability much more than the computers that were used in Apollo Mission to send the first man to moon!.The proliferation of mobile phones has changed not just the telecom industry but also others like communication, banking e-commerce etc. The pace of change is both exhilarating and challenging.

To manage this complex scenario a company cannot focus on only one aspect of their operations. Optimize processes, delivery quality to customers, manage employee talents, earn required return on investment while managing to be a socially responsible organization. In short, the company should achieve excellence in all aspects of its operations. This is business Excellence. Business excellence principles emerged because of development of quality drive into traditional business management. It is imperative not just to achieve excellence but also to sustain it.

Business excellence models are holistic tool that help companies develop stakeholders focused strategy. Each operation within a company enables a corresponding result. Business models present a formal, standardized cause effect relationship between different operations (enables) and their resultant consequences. If the company want to achieve a different result, it has to do things differently. This can be better analysed through these models. Continuous improvement on various operations will ultimately lead to excellence. More importantly these models need to be used to sustain and maintain excellence to retain their competitive advantage. They are not to be taken as one time exercise by the company. Assessments using the model have to be made periodically so that timely action can be taken to achieve the desired result.

(i) Some of the popular business excellence models are (i) the European foundation quality management (EFQM) model (ii) Baldrige Criteria for performance Excellence (iii) Singapore BE framework (iv) Japan Quality Award Model and (iv) Australian Business Excellence Framework.

(ii) The apparel company is a well-established player in the industry. It is a growing company that is looking to expand its operations overseas. To achieve business excellence in this environment, the company could adopt the EFQM model, which is a popular model.

The EFQM model was developed by the European Foundation for Quality Management. The model provides an all-round view of the organization and it can be used to determine how different methods for together and complement each other. It can help the company understand the cause and effect relationship between what their organization does and the results it achieves. Creating an EFQM Management Document gives the organization a holistic overview of its strategic goals, the key approaches it has adopted and the key results it has achieved.

The fundamental concepts for excellence are the basic principles that describe the essential foundation for any organization to achieve sustainable excellence. With respect to the company they can be detailed as below:

(a) Adding value to customers: Companies need to understand their customers, their needs, anticipate their needs and make use of opportunities to fulfill their expectations.

In the current case, fashion apparel business is ever changing and dynamic due to the changing trends in customer's tastes. This could differ across locations within India and abroad. In the ear of e-commerce, competition would be cut-throat. Before going to "how" it can meet customer's needs, the company should be clear on "What" need of the customer it can satisfy. For example, should the company cater to Indian apparel market, western apparel market, men or women or children apparel market etc. Once the "What" is clear, the company should have mechanisms in place to find out and anticipate customer tastes. Accordingly, it should structure its operations to add value to the customers in terms of quality, availability, support, and experience.

(b) Creating a sustainable Future: Society and environment (People an d Planet of Triple Bottom-line concept) play a major role in ensuring the sustainability of business. A company should have as much positive impact on its surroundings and try to minimize any negative impact on the same. Here the company should assess the environmental impact of its operations, measures to minimize adverse impacts, business impact on the society etc. For example, leather is contended to be harmful to the environment since it requires the skin of animals specially cattle hide, needs huge amount of energy and chemicals to process it. This has a negative environmental impact. As regards societal impact, suppliers of cloth to the apparel company should not indulge in labor malpractice alike child labor and should adhere to safety standards within its factories. The company should procure cloth only from suppliers who adhere to such standards.

(c) Developing Organizational Capability: Companies need to manage change within the organization and beyond. The company should identify "What it is capable of being great at?". In order to differentiate it from its competitors. For example the apparel company may have the capability of tracking its inventory at the stores on real time basis. As soon as the inventory falls below a certain level, the stores issues fresh products to stock up. This ensures that there are no stock outs at the retail outlet. This ability to track gives ti a competitive edge. Another can be the ability to quickly change the apparel production to meet changing trends. Likewise, the company should identify and develop unique capabilities to have a competitive edge in the market.

(d) Harnessing creativity and innovation: Continuous improvement and innovation brings value to the company. The company should promote a working environment that enables and appreciates creativity and innovation. For example, new apparel designs can be promoted to test the market. If found feasible the company can go for mass production of the same.

(e) Leading with vision, inspiration and integrity; The tone at the top defines the rest of the company. The leaders and management of the company should have a clear vision of what the company wants to achieve, develop strategy to achieve it, work with integrity and ethics. Leaders shape the future of the organization.

(f) Managing with agility: Agility would be the capability to identify and effectively respond to opportunities and threats. For example although the apparel company is in an expansionary phase, it should consider the threat, yet opportunity of using e-commence as a platform to reach out to customers directly. Brick and mortar stores are becoming largely redundant due to online platforms, a threat the company should recognize and act upon.

(g) Succeeding though the talent of people: An Organisation is only as good as the people who work in it. There should be an atmosphere of teamwork that enable achievement of organizational and personal goals. Performance evaluation, reward and recognition programs, training and talent network are ways to cultivate talent within the organization.

(h) Sustaining outstanding results: Use of EFQM model is not a onetime exercise. Constant and periodic evaluation is required to keep up and sustain excellence.

(iii) The criteria of the model are comprised of 5 enables and 4 results. Enables covers what an organization does (its objective) and how it does it (Strategy, use of resources to achieve it).

(a) **Leadership:** A leader defines the organization's cuisation to achieve its goals by taking the correct decisions at the correct time. TO do this they should have sufficient skill, work as per the company's code of conduct and should be ethical in their dealings.

(b) **Strategy:**Operations should be planned and directed as per a clearly defined strategy. The company's vision and mission statement with respect to its various stakeholders are the goals that the organization wishes to achieve. Strategy (plan) enables the company to achieve these goals.

(c) **People:** Excellence is possible only if the people working in the company wish to achieve it. They must be motivated, recognized and managed to enables them to work towards the company's vision and mission. The work culture should be that this opens up opportunities for personal development as well. This would cultivate a bond with the organization, which enables people working within the strive for excellence.

(d) **Partnerships and resources:** Effective management of partnerships that the company has with other organizations is critical to success. Partners could be external vendors, suppliers and service providers. The services of partners enables business to operate smoothly. Resources, both tangible and intangible should be managed optimally. Tangible resources can be financial (Cash, bank, accounts) and physical assets (machinery, building, land, etc) Intangible resources would be intellectual property rights, information technology, License etc. Proper management of resources enables optimal results.

(e) **Processes, Products and Services:** A company exists because of its processes, products, and services. They should be managed and continuously improved to create value to the stakeholders.

Results are what the organization achieves following its operations and decisions. As explained before the stakeholders of the company are investors (business), People (employees), customers and society. In order to track performance, the company has to develop key Performance Indicators (KPI)s for each of the stakeholder groups. Results should be tracked periodically. Changes to targets and benchmarks should be continuously made to reflect the current objectives that the company wants to achieve. Some of the results that the company can look at are:

(a) **Customers results:** Are the customers of the company satisfies with the products and service? How does the company fare in terms of brand loyalty? Is the customers base growing to indicate increasing market share?

(b) **People results:** Does the company have skilled and motivated employees? What is the employee turnover with reasons for the same? Does the company have proper access to hire required talent? Are the employees motivated, trained, recognized, and rewarded for their performance? What is Performance measurement system, is ti robust and accurate to measure performance?

(c) **Society results:** is the company a good corporate citizen. Are the objectives of corporate social responsibility being met? If the organization is a not for profit organization, is it meeting its objectives and goals?

(d) **Business results:** is a for profit organization achieving the required return on investment, profitability that the shareholders and other investor demand? Has the company been able to manage financial and other risks properly?

Enablers enable achievement of results. EFQM model documents this flow and symbiosis in a structures way. It highlights the strength and weakness of the enables. With this information, the company can alter its Operations and strategy to achieve desired results. On assessment, there is a flow from results to enables. If the results have been achieved enables continue to operate status quo. If the results fall short of targets changes have to be made to enables to improve performance.

Therefore, it can be concluded the EFQM model encourages constant self-assessment to achieve excellence.

When a company wins an excellence award based on a business excellence model, it gains in stature within the industry. This recognition could work to its advantage financial otherwise.

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SUPPLY CHAIN MANAGEMENT

The Global Supply Chain Forum (GSCF) defines Supply chain management as the "integration of key business processes from end user through original suppliers that provides products, services, and information that add value for customers and other stakeholders".

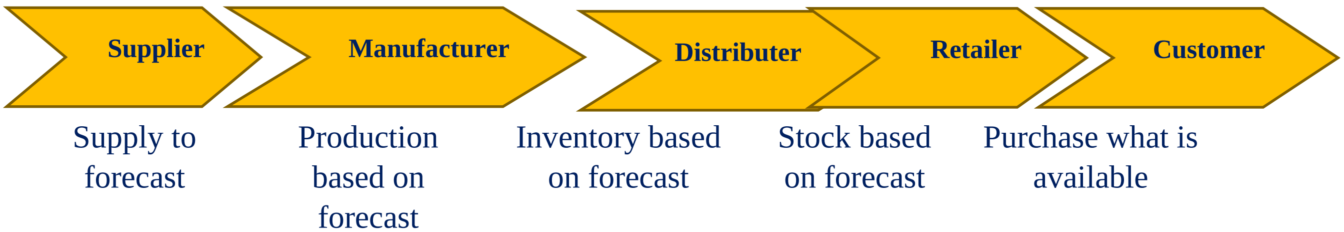
The following eight supply chain management processes are included in the GSCF framework:

▪	**Customer Relationship Management**, to manage and analyze customer's interaction and data throughout the life cycle with the main motive of improving business relations.
▪	**Supplier Relationship Management,** provides the structure for how relationships with suppliers are developed and maintained.
▪	**Customer Service Management,** provides the key points of contact for administering product and service agreements.
▪	**Demand Management, provides the structure for optimizing the customer's requirements with supply chain capabilities.**
▪	**Order Fulfillment, includes all activities necessary to define customer requirements, design the logistics network, and fill customer orders.**
▪	**Manufacturing Flow Management, includes all activities necessary to move products through the plants and to obtain, implement and manage manufacturing flexibility in the supply chain.**

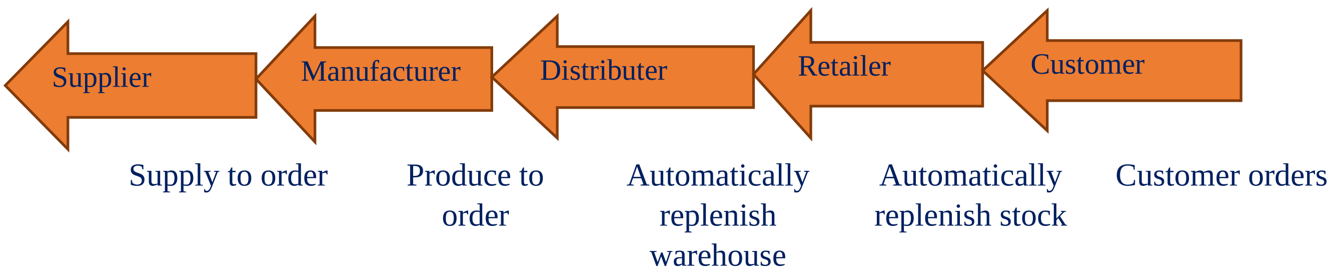
- Product Development and Commercialization, provides the structure for developing and bringing to market new products jointly with customers and suppliers.
- Returns Management, includes all activities related to returns, reverse logistics, gatekeeping, and avoidance.

Types of Supply Chain- Push and Pull

Push Model



Pull Model

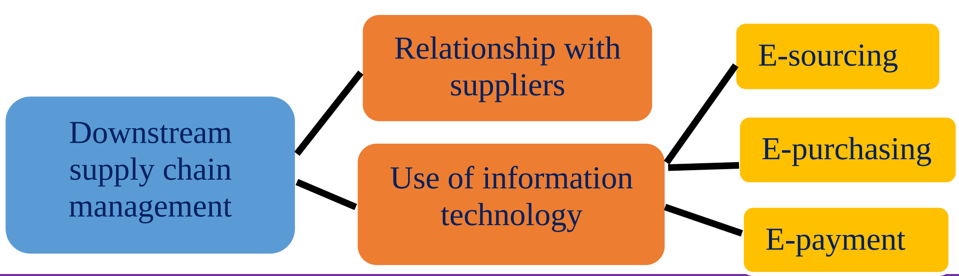


Upstream and Downstream Flow

A supply chain begins right from the supplier and finally ends on end customer or consumer. In the total chain there are flows of material, information and capital or finance. When the flow relates to supplier it is termed as upstream flow. If the flow is with consumers or customers it is named as downstream flow. For instance, upstream and downstream include flows as demonstrated in the below tabular format:

Management of Upstream Supplier Chain

Management of transactions with suppliers are termed as upstream supply chain management



Relationship with Suppliers

Supplier Relationship Management (SRM) is undergoing a major transition. In today's global economy there are so many factors to consider when choosing and managing a supplier. Supplier capabilities of innovation, quality, reliability and costs/price reductions and agility to reduce risk factors all have witnessed significant changes when aligned with key suppliers. Greater value can be achieved for both businesses, something that would be difficult to achieve if operating independently.

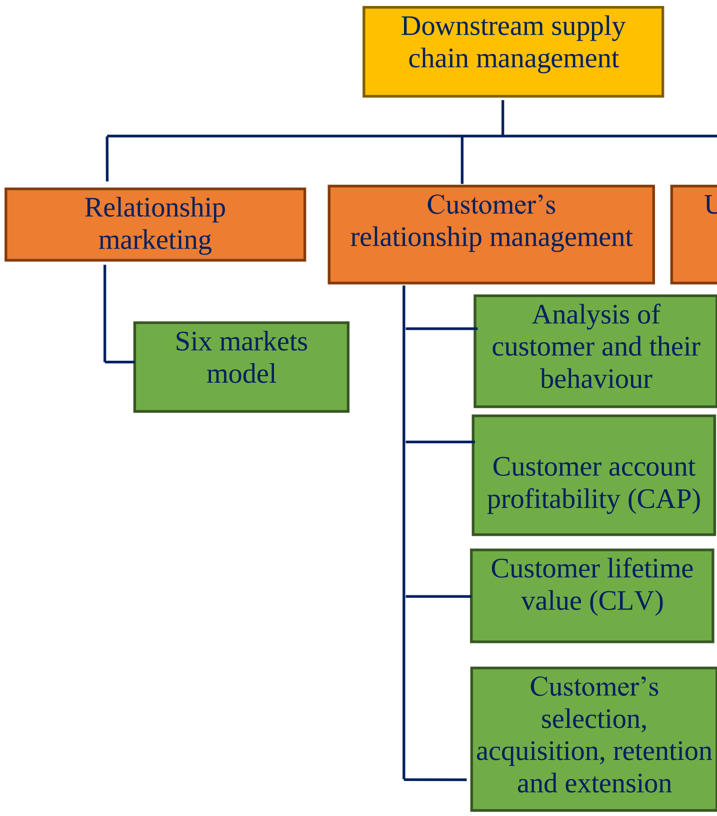
Use of Information Technology

The main activities of upstream supply chain are procurement and logistics. In modern business environment upstream supply chain management use E-Procurement process. E-Procurement is the electronic methods beginning from identification of the organization's requirements and end on payment.

E-Procurement includes E-Sourcing, E-Purchasing and E-Payment.

Downstream Supply Chain Management

Management of transactions with consumers or customers are termed as downstream supply chain management.



Concept of Supply Chain:

Imagine a (Simplified) supply chain for a large, national baker who makes and sells bread through a chain of supermarkets.

Farmer → Mill → Wholesaler → baker → supermarket → consumer

The baker makes bread with wheat. This means that the supply chain starts with the farmers who grow the wheat-the original creator of the resource. The farmers then sell this wheat to mills, who convert the wheat into flour. The flour is then purchased by wholesalers who sell the flour in bulk to larger companies, such as our baker. The baker makes the loaves of bread and sells it onto the supermarkets who sell the bread onto the end consumers (Customers).

Management of the supply chain means that the baker needs to be aware of the activities and needs of each part (or node) of the supply chain- from the farmer to the end consumer.

The baker's upstream supply chain includes farmers, mills and wholesalers while its downstream supply chain is made up of supermarkets and consumers.

Note that problems in any part of the supply chain can affect the baker. For example, if farmers switch from growing wheat to other, more profitable crops then it will lead to a scarcity of flour on the market, pushing the baker's costs up. If the end consumers start to dislike the types of bread that the baker is selling (For example if the market shifts away from while bread to brown or granary breads) then this will affect how many of the baker's products will be stocked by the supermarkets.

As such, even though the baker may not directly transact with the consumers and the farmers, it is till affected by them as they are part of its supply chain.

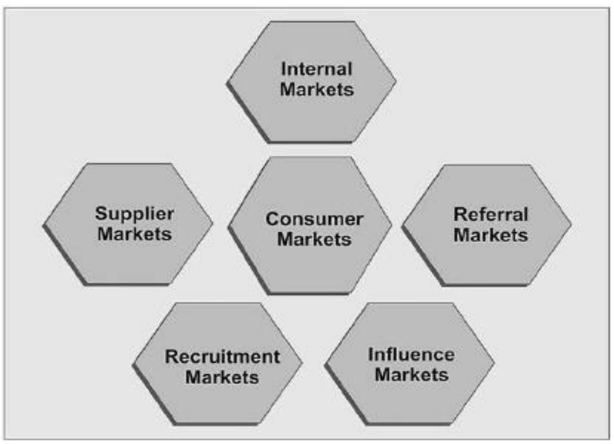
It is worth noting that managing the supply chain and moving materials and products from node to node includes activities such as:

- Production Planning
- Purchasing
- Materials management
- Distribution
- Customer service
- Forecasting.

Relationship Marketing

Marketing plays a vital role to successfully handle the downstream supply chain management. The Relationship marketing helps the organization to keep existing customer and to attract new customers through helpful staff, quality service/product, appropriate prices and proper customer care etc.

Six Markets Model identifies the six key "market domain" where organizations may consider directing their marketing activities.



The six markets model suggests that a firm must regulate its actions towards developing appropriate relationships with each of the market areas as the management of relationships in each of the six markets is critical for the attainment of customer retention objective.

Service Level Agreements (SLA)

An agreement between the customer and service provider is termed as a service-level agreement. This can be a legally binding formal or an informal "Contract". The agreement may be between separate organization or within different teams of the organization. SLAs commonly include many components, from a definition of services to the termination of agreement. To ensure that SLAs are consistently met, agreements are often designed with specific lines of differentiation and the parties involved are required to meet regularly to create an open forum for communication. Providers rewards and penalties are specified. There is always place left for revisiting in most SLA.

Benefits of Supply Chain

Benefits of supply chain are enormous on any business. Highly controlled supply chain fetches tangible benefits such as inventory reduction, personnel reduction, productivity improvement; order management improvement, financial cycle improvement etc. Further it results in information visibility, new/improved processes, customer responsiveness, standardization –flexibility & globalization of business performance.

Customers Relationship Management

To manage and analyse customer's interaction and data throughout the life cycle with the main motive of improving business relations the strategies and technologies used is Customer Relationship Management (CRM). Relation includes relations with customers, assisting in customer retention and driving sales growth.

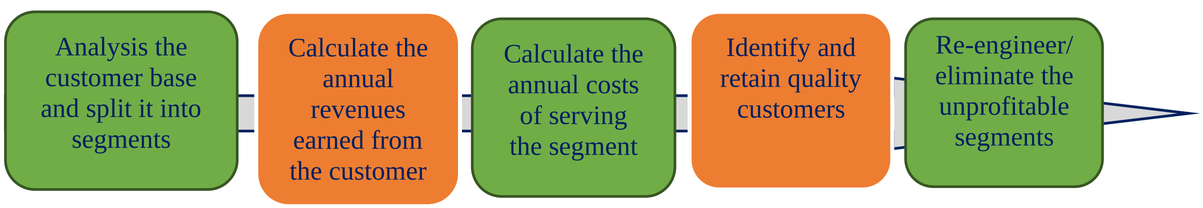
Analysis of Customers and their Behavior

Analysis of customers is necessary based on geographical location or purchasing characteristics.

For industrial customer expectation of benefits - quality, discount, serviceability, size of the should be taken into consideration. During such analysing process, management should keep in mind the physiological need, safety need, social need, status/ego need and self-fulfillment need of existing and future customers.

Customers Account Profitability (CAP)

Undertaking a customer account profitability improvement initiative is a five-step process:



Gain Sharing Arrangements

Gain sharing is an approach to the review and adjustment of an existing contract, or series of contracts, where the adjustment provides benefits to both parties.

Gain Sharing Arrangement:

1. It's an arrangement between Supplier & Customer.
2. Both Will be benefited.
3. Supplier receive higher huge return when benefit to the customer are very high. Supplier receive low return when benefit from customer are very low. No guarantee payment will be made to supplier.
4. If supplier act adversial behavior, hiding the contract, No reward will be given to supplier.

Gain Sharing arrangements:

In simple terms, gain Sharing is a program that returns cost savings to the employees.

While risk-sharing/gain –sharing arrangements can take different forms, companies typically guarantee their customers that they will achieve a certain amount of cost savings or top=line improvement. If targets are not met, the company commits to making up the difference in cash. If however targets are exceeded, the supplier may also receive a pre-specified percentage of the gains.

These agreements are attractive to companies because they can provide insulation from the cutthroat price competition that characteristics today's technology marketplace. Suppliers that guarantee cost savings and top-line improvement can command a price premium in the marketplace. Such risk-sharing agreements are attractive to customers because they reduce the business risk and cost associated with implementing new technologies, systems and services.

Gain-Sharing is an approach to the review and adjustment of an existing contract or series of contracts, where the adjustment provides benefits to both parties. It is a mutual activity requiring the agreement of both parties to the contract adjustment. Consideration of a gain-sharing proposal will be limited to just that area affected by the proposal.

The sharing of benefits provides an incentive to both parties to a contract to explore gain-sharing possibilities. In the UK the Ministry of Defense is committed to and industry supports, gain sharing as one of a number of approaches to improve the efficient use of the defence procurement budget.

Gain-Sharing arrangements are popular where there exists the potential to achieve mutual benefit among the parties concerned. The gain, benefit or advantage are likely to feature strongly. The period of application of the sharing arrangement will need to be agreed. The sharing arrangement may apply only to the current contract, or the effects of the agreement, and the sharing arrangements, may be carried forward into future contracts.

Mutual trust and Co-operation between contracting parties is essential since assessment of the financial benefit of a gain-sharing proposal will require both parties to provide each other with access to relevant cost data to provide the basis for the valuation of the benefit and to facilitate the calculation and sharing of that benefit.

Gain Sharing represents are a reward for innovative thinking by the contractor, it is important that the nature of any change proposal is agreed at the outset in the light of this principle. Once a gain-sharing proposal is agreed, the concept of sharing the benefits will be fundamental to further discussion and agreement: neither party will seek to secure all the benefits.

A gain Sharing arrangement must possess the following components:

(i) Mutual interdependence and trust between the parties (as opposed to a blame culture).

(ii) Identification of common goals for success.

(iii) Agreed decision-making and problem –solving procedures.

(iv) Commitment to continuous improvement.

(v) Team working down the entire product and supply chain.

(vi) Gain-sharing and pain share arrangements established in advance.

(vii) Open book accounting.

(viii) Targets that provide continuous measurable improvements on performance.

Examples:

Public Sector	**Private Sector**
The Government Travel savings Program is a gain-sharing arrangement that rewards federal government employees who save money while on official travel. In general, the cash awards equal 50% of the savings on lodging expenses and/or contract carrier airfare. For example. Government employees who stay with relatives or friends and avoid lodging expenses while on official travel receive one-half of the allowed	Gain Sharing involves the process by which a hospital and its medical staff identify clinical practices that increase hospital operating costs without improving quality of care, develop initiative to reduce or eliminate such practices while maintaining quality of care, and share the resulting cost savings directly attributable to the clinical initiatives.

maximum lodging rate (US)	
Gain Sharing in a court might depend on a court unit or program hitting performance targets such as a specific decrease in cost per case, an improvement in trial date certainty or juror utilization, which positively impacts the bottom line of budgets and balance sheets of the court. A decrease in cost per case might be seen directly in a court's balance sheet, while an improvement in trial date certainly may be seen most significantly in decreased expenditures for witness notification by the prosecution.	A Company produces rigid and steering differential axles for tractors. From its records the company determined that every $1,000,000 of good product output required 10,000 workers hours. Under gain-sharing the next $1,000,000 of axle output and shipment was produced with only 9,000 hours. If the average wage rate is $10 an hour, the 1,000 hours saved are worth $ 10,000. That is a gain to be shared equally between the workforce and company.

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Case study On Gain Sharing Arrangement

Question 24:- Raya Health Care Limited is a leading healthcare service provider in Mumbai, it has approximately 450 potential beds, it provides diagnostic and day care speciality facilities also. In diagnostic centres they are using traditional devices for CT Scan and MRI which are not enough as per demand. Patients waited more than weeks for CT and MRI scans, this problem can cause delay in diagnosing illness; waste of time and other resources; not just in radiology but throughout the healthcare system.

Raya has planned to outsource CT scan and MRI services to Livlife, which has world- class international chain of diagnostic centre. Livlife promise to provide radiologist report within 24 hours. However, finance manager of Raya doubt that it will not be a profitable arrangement. For the satisfaction of Raya, Livlife has entered an agreement to provide its services to Raya with no guarantee of receiving payment. Raya agrees to the following conditions:

- Cost savings generated in first year, the same will be retained by Livlife.
- Cost savings generated in second and third year will be shared between Raya and Livlife at a ratio of 30%:70%.
- Cost savings generated in the fourth year will be passed to Raya.
- Any cost savings generated by an idea proposed exclusively by Raya that does not require capital investment by Livlife will be immediately passed along to Raya.

Required

DISCUSS the agreement between Raya and Livlife.

Solution:- The agreement between Raya and Livlife is **Gain Sharing Arrangement**. Gain sharing (also known as cost saving sharing) arrangement is an approach to the review and adjustment of an existing contract, or series of contracts, where the adjustment provides *benefits to both parties*. A fundamental form of gain-sharing is where a supplier agrees to perform its side of the contract with *no guarantee* of receiving a payment. Instead, any payment received is based upon the benefits that emerge to the customer as a result of the successful completion of the supplier's side of the bargain.

Livlife and Raya has also entered into such arrangement. This is clearly a risky stance for the supplier i.e. Livlife, because it could spend a fortune and walk away with nothing. Alternatively, if the benefits to Raya are substantial, Livlife could find itself rewarded with a large return. Cost savings might be attained from reducing the cost of supplies, implementing new skill and technologies, revised delivery time, improvements in operations etc.

The gain, benefit, or advantage to be shared is ***not necessarily financial*,** although financial benefits are expected to occur frequently. The Raya, for instance, will not necessarily take cost savings in the form of a lower contract value but might require a *higher specification* for medical treatment. However, to assess any financial benefit, both parties have to provide each other with access to relevant cost numbers to determine the basis for the assessment of the benefit and the calculation and sharing of the benefit**.**

Many contracts involving these arrangements have emphasis on greater openness and shared development and improvement. In the given case gain-sharing deals are, on the face of it, a win-win situation for both Raya and Livlife, interest of both are aligned. Livlife is trying to save costs of Raya while Raya is trying to get world class services.

Reason of failure of Gain Sharing Arrangement – Gain sharing Arrangement sounds great but in practice it is quite difficult to execute. Even after a considerable level of efforts due to following reasons it may fail;

a.- Unstructured/Poorly structured terms of arrangement, in outsourcing contracts.

b.- Error in implementation.

c.- Relation between outsource supplier and entity.

Precaution need to be taken – Action plan for executing gain share arrangement must contain;

A:- Be specific in outsourcing agreement.

B:- Predefined formula for sharing of benefits and period thereof.

C:- Effort from entity, because innovation is not only responsibility of outsource supplier.

D:- Constitute innovation team to create an innovation structure generate the idea and execution of same.

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Business Excellence Model

Question 41: As a guest lecturer at a symposium for Business Excellence where you are giving a lecture on “Sustaining Business Excellence”. A manufacturer of a fashion clothing line is one of the participants at the symposium. He has the following query:

“We are an apparel company that manufacture and sell our fashion clothing and accessories directly through 30 stores spread across India. Shortly we are planning to establish similar outlets overseas. Our business is under constant change due to changing customer terns, At the same time, we are the largest company in our industry segment in India, both in terms of market share and profits. We have a satisfied base of customers who are loyal to our brand.

Shareholders are also satisfied stakeholders due to good returns provided on their investments. What would be the relevance of Business Excellence model to our company?

Thank you".

You are required to frame an appropriate response to this query.

Required:—

(i) Explain the importance of business excellence to an organization.

(ii) List the tool available to achieve and sustain excellence.

(iii) Apply the fundamentals of EFQM model on the appeal company.

(iv) Explain the relationship between various criteria of the model in general terms.

Solution: (i) Business Excellence is a philosophy for developing and strengthening the management systems and processes of an organization to improve performance and create value for stakeholders. Stakeholders in an organization are not limited to shareholders (business) alone. They include also customers, employees (people) and society. What an organization does impact all the stakeholders in different ways, yet they are all interlinked to each other. Customers' needs are of paramount importance to companies. Yet given uncertain conditions, shareholders demand challenging return on their investments. Employees need more from their company than just their pay-check. They want the company to enable to grow their knowledge and experience that can improve their career growth. Society expects companies to operate ethically and for the overall betterment of the society and environment.

For several years businesses have been operating under challenging circumstances. For example, landline phones have been entirely replaced by mobile phones. Television programs can be watched seamlessly on internet enabled mobile phones. Not just this, today's smart phones have computing capability much more than the computers that were used in Apollo Mission to send the first man to moon! The proliferation of mobile phones has changed not just the telecom industry but also others like communication, banking, e-commerce etc. The pace of change is both exhilarating and challenging.

To manage this complex scenario, a company cannot focus on only one aspect of their operations. Optimize processes, delivery quality to customers, manage employee talents, earn required return on investment while managing to be a socially responsible organization. In short, the company should achieve excellence in all aspects of its operations. This is business excellence. Business excellence principles emerged because of development of quality drive into traditional business management. It is imperative not just to achieve excellence but also to sustain it.

Business excellence models are holistic tools that help companies develop stakeholder focused strategy. Each operation within a company enables a corresponding result. Business models present a formal, standardized cause effect relationship between different operations (enablers) and their resultant consequences. If the company want to achieve a different result, it has to do things differently. This can be better analysed through these models. Continuous improvement on various operations will ultimately lead to excellence. More importantly, these models need to be used to sustain and maintain excellence to retain their competitive advantage. They are not to be taken as one time exercise by the company. Assessments using this model have to be made periodically so that timely action can be taken to achieve the desired result.

(ii) Some of the popular business excellence models are (i) the European Foundation Quality Management (EFQM) model (ii) Baldrige Criteria for Performance Excellence (iii) Singapore BE Framework (iv) Japan Quality Award Model and (iv) Australian Business Excellence Framework.

(iii) The apparel company is a well-established player in the industry. It is a growing company that is looking to expand its operations overseas. To achieve business excellence in this environment, the company could adopt the EFQM model, which is a popular model.

The EFQM model was developed by the European Foundation for Quality Management. The model provides an all-round view of the organization and it can be used to determine how different methods fit together and complement each other. It can help the company understand the cause and effect relationships between what their organization does and the results it achieves. Creating an EFQM Management Document gives the organization a holistic overview of its strategic goals, the key approaches it has adopted and the key results it has achieved.

The fundamental concepts for excellence are the basic principles that describe the essential foundation for any organization to achieve sustainable excellence. With respect to the company they can be detailed as below:

(a) Adding value to customers: Companies need to understand their customers, their needs, anticipate their needs and make use of opportunities to fulfill their expectations.

In the current case, fashion apparel business is ever changing and dynamic due to the changing trends in customer's tastes. This could differ across locations within India and abroad. In the era of e-commerce, competition would be cut-throat. Before going to "how" it can meet customer's needs, the company should be clear on "what" need of the customer it can satisfy. For example, should the company cater to Indian apparel market, western apparel market, men or women or children apparel market etc. Once the "what" is clear, the company should have mechanisms in place to find out and anticipate customer tastes. Accordingly, it should structure its operations to add value to the customers in terms of quality, availability, support, and experience.

(b) Creating a sustainable future: Society and environment (People and Planet of Triple Bottom-line concept) play a major role in ensuring the sustainability of business. A company should have as much positive impact on its surroundings and try to minimize any negative impact on the same. Here, the company should assess the environmental impact of its operations, measures to minimize adverse impacts, business impact on the society etc.

For example, leather is contended to be harmful to the environment since it requires the skin of animals specially cattle hide, needs huge amount of energy and chemicals to process it. This has a negative environmental impact. As regards societal impact, suppliers of cloth to the apparel company should not indulge in labor malpractice like child labor and should adhere to safety standards within its factories. The company should procure cloth only from suppliers who adhere to such standards.

(c) Developing Organizational Capability: Companies need to manage change within the organization and beyond. The company should identify "what it is capable of being great at?" in order to differentiate it from its competitors. For example, the apparel company may have the capability of tracking its inventory at the stores on real time basis. As soon as the inventory falls below a certain level, the stores issues fresh products to stock up. This ensures that there are no stock outs at the retail outlet. This ability to track inventory real time and ability to stock up quickly may be unique to the company that gives it a competitive edge. Another can be the ability to quickly change the apparel production to meet changing trends. Likewise, the company should identify and develop unique capabilities to have a competitive edge in the market.

(d) Harnessing creativity and innovation: Continuous improvement and innovation brings value to the company. The company should promote a working environment that enables and appreciates creativity and innovation. For example, new apparel designs can be promoted to test the market. If found feasible, the company can go for mass production of the same.

(e) Leading with vision, inspiration, and integrity: The tone at the top defines the rest of the company. The leaders and management of the company should have a clear vision of what the company wants to achieve, develop strategy to achieve it, work with integrity and ethics. Leaders shape the future of the organization.

(f) Managing with agility: Agility would be the capability to identify and effectively respond to opportunities and threats. For example, although the apparel company is in an expansionary phase, it should consider the threat, yet opportunity of using e-commerce as a platform to reach out to customers directly. Brick and mortar stores are becoming largely redundant due to online platforms, a threat the company should recognize and act upon.

(g) Succeeding through the talent of people: An organization is only as good as the people who work in it. There should be an atmosphere of teamwork that enable achievement of organizational and personal goals. Performance evaluation, reward and recognition programs, training and talent network are ways to cultivate talent within the organization.

(h) Sustaining outstanding results: Use of EFQM model is not a onetime exercise. Constant and periodic evaluation is required to keep up and sustain excellence.

(iv) The criteria of the model are comprised of 5 enablers and 4 results. Enablers covers what an organization does (its objective) and how it does it (strategy, use of resources to achieve it).

(a) Leadership: A leader defines the organization's culture. They enable the organization to achieve its goals by taking the correct decisions at the correct time. To do this they should have sufficient skill, work as per the company's code of conduct and should be ethical in their dealings.

(b) Strategy: Operations should be planned and directed as per a clearly defined strategy. The company's vision and mission statement with respect to its various stakeholders are the goals that the organization wishes to achieve. Strategy (plan) enables the company to achieve these goals.

(c) People: Excellence is possible only if the people working in the company wish to achieve it. They must be motivated, recognized, and managed to enable them to work towards the company's vision and mission. The work culture should be that this opens up opportunities for personal development as well. This would cultivate a bond with the organization, which enables people working within to strive for excellence.

(d) Partnerships and resources: Effective management of partnerships that the company has with other organizations is critical to success. Partners could be external vendors, suppliers, and service providers. The services of partners enable business to operate smoothly. Resources, both tangible and intangible should be managed optimally. Tangible resources can be financial (cash, bank accounts) and physical assets (machinery, building, land etc.). Intangible resources would be intellectual property rights, information technology, licenses etc. Proper management of resources enables optimal results.

(e) Processes, Products, and Services: A company exists because of its processes, products, and services. They should be managed and continuously improved to create value to the stakeholders.

Results are what the organization achieves following its operations and decisions. As explained before, the stakeholders of the company are investors (business), people (employees), customers and society. In order to track performance, the company has to develop Key Performance Indicators (KPI)s for each of the stakeholder groups. Results should be tracked periodically. Changes to targets and benchmarks should be continuously made to reflect the current objectives that the company wants to achieve. Some of the results that the company can look at are:

(a) Customer results: Are the customers of the company satisfied with the products and service? How does the company fare in terms of brand loyalty? Is the customer base growing to indicate increasing market share?

(b) People results: Does the company have skilled and motivated employees? What is the employee turnover with reasons for the same? Does the company have proper access to hire required talent? Are the employees motivated, trained, recognized, and rewarded for their performance? What is performance measurement system, is it robust and accurate to measure performance?

(c) Society results: Is the company a good corporate citizen. Are the objectives of corporate social responsibility being met? If the organization is a not for profit organization, is it meeting its objectives and goals?

(d) Business results: Is a for profit organization achieving the required return on investment, profitability that the shareholders and other investor demand? Has the company been able to manage financial and other risks properly?

Enablers enable achievement of results. EFQM model documents this flow and symbiosis in a structured way. It highlights the strength and weakness of the enablers. With this information, the company can alter its operations and strategy to achieve desired results. On assessment, there is a flow from results to enablers. If the results have been achieved, enablers continue to operate status quo. If the results fall short of targets, changes have to be made to enablers to improve performance.

Therefore, it can be concluded the EFQM model encourages constant self- assessment to achieve excellence.

When a company wins an excellence award based on a business excellence model, it gains in stature within the industry. This recognition could work to its advantage financially and otherwise.

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Case Study: (Supply Chain Management)

Sun Electronics manufactures and sells various electronic goods like mobile phones, laptops, televisions, refrigerator etc. the company sells these goods through the 30 stores situated in different parts of the country. The store managers place a request to the centralized team situated in Mumbai on a monthly basis. One store can send only one requisition per month.

The requirements of the stores are forwarded to the production planning team which is responsible for scheduling the manufacturing of these products. Once the goods are manufactured, the goods are sent to a central warehouse in Mumbai and are dispatched to different stores according to the store requirements. The time taken from placing a request from store to the delivery of product to the store takes about 30-40 days on an average. In the process the company procures parts from more than 100 vendors. The company has faced quality related issues with many vendors leading to delay in production.

The average holding period of inventory in Sun Electronics is very high at 45 days as against an industry average of 15 days. Since the order to delivery time at store is very high, the company has traditionally allowed high inventory holding to reduce the stock outs at store level. The company is under severe pressure to improve its working capital cycle.

A high amount of inventory held at each store also means that the products become obsolete quickly. In case of products like mobile phones, new and upgraded versions are available in the market as early as six months from the date of initial launch of a particular model. A significant portion of inventory of mobile phones becomes obsolete every year. The company generally resorts to a discounted sale to liquidate such obsolete models.

The management at Sun Electronics has identified e-commerce as an opportunity for faster growth, both in terms of revenues and profitability. The company is considering launch of its own e-commerce website to sell all products which are currently being sold in physical stores. Depending upon the success of online sales, the company might choose to optimize and close certain physical stores in the next couple of years.

The management of the company is cognizant of the fact that existing inventory procurement and management system will not fit in the new e-commerce business. E-Commerce works on a inventory light model and quick as well as on time delivery of products of the customers. The fact that customers could be from a location other than those where Sun Electronics has physical presence makes the matter complex.

Required

The company is considering implementation of a supply chain management system. Will a supply chain management system be of use to Sun Electronics in light of the e-commerce venture? You are required to EXPLAIN the concept of Supply Chain Management and EVALUATE the applicability of in the current case.

Issue

Sun electronics manufactures and sells various electronic products through its physical stores. The existing manufacturing system does not take into consider the demand of product in the market. Store managers are allowed to submit only one order per month. A high level of inventory can be seen at Sun Electronics as compared to the industry average. The store managers tend to keep high level of inventories as a safe guard against stock-outs. Whereas, keeping inventory to meet customer requirement is good, high level of inventories due to inefficient processes is not advisable.

The company also has a longer working cycle because of a long order to deliver time and excess holding of inventory. A significant amount of working capital is blocked due to this practice. Technology changes rapidly and the company is expected to roll out latest products in the market. A product like mobile gets outdated very soon and the company has to resort to discounted sales. This results in financial losses to the company.

The company has identified an opportunity in e-commerce. E-commerce businesses require leaner models and faster response time. The production must be based on the demand from the customer and not on an ad-hoc basis. In the following paragraphs, the importance of supply chain management (SCM) and its applicability in the current case is discussed.

Supply chain management (SCM)

Supply chain management can be defined as the management of flow of products, services and information, which begins from the origin of products and ends at the product's consumption at consumer's end. SCM also involves movement and storage of raw material, work in progress and finished goods. In other words, supply chain management involves management of all activities associated with moving goods from the raw materials stage to the end user. An important objective of SCM is to correlate the production and distribution of goods and services with demand of the product.

The following are the various activities which an organization carries out to meet the customer requirements (primary activities under value chain model) –

- Inbound logistics covering procurement and related activities.
- Operations covering conversion of raw materials into finished products
- Outbound logistics covering movement of products from plants to end users
- Marketing and sales
- Service

Supply chain management looks each o the above activities as integrated and interrelated to each other. None of the activities can be looked in silos. In the case of Sun Electronics, there is a restriction on number of orders which a store manager can place. This would lead to excess ordering because of the fear of stock-outs.

The customer demand is completely ignored and hence the production is not in sync with the market demand. This could lead to excess production, higher inventory holding and longer working capital cycles.

The facts presented in the case indicate the following problems at Sun Electronics:

- Production planning is not based on customer demand & is done on an ad-hoc basis.
- Inventory holding period is very high (45 days against an industry average of 15 days).

- The working capital cycle is longer.
- The time take to fulfil an order from the store is very high.
- The production is dispatched to a central warehouse for further deliveries to the stores. This could be an inefficient process.
- Liquidation of products at discount for products with low shelf life.

SCM process and applicability to Sun Electronics

The SCM process is explained below:

- **Plan** – the first step in SCM process is to develop a plan to address the requirements of the customer. Sun Electronics must shift its focus from ad hoc and predetermined production planning to understanding the requirements of customers. Production must be planned based on the demand of products. The focus must be on producing what the customer wants.
- **Develop (procure)** – in this step, the materials required for production is sourced from various suppliers. A good relationship with supplier is required to ensure that the parts/materials are received as and when required by the production team. It is also important that the vendors supply quality material which is not the case in Sun Electronics. The company must select suppliers which are dependable and can deliver quality products in the stipulated time. The company must focus in reducing the lead time required for sourcing materials which will reduce the inventory holding period.
- **Make** – the third step is making or manufacturing the products required by the customer. This is quite different from the existing practice in Sun Electronics where store managers are allowed to place only one order. This would mean that the company is not considering the ever changing demands and tastes of the customers.
- **Deliver** – the fourth stage is to deliver the products manufactured for the customers. This stage is concerned with logistics. The time required to deliver to the store in case of Sun Electronics is very high. The company must evaluate if the centralized warehouse is causing delay in delivery of products to the stores.

Logistics is one of the important components of the entire supply chain process. Right from procurement of material, movement of raw material in the plants and final delivery of products of customers, logistics plays a critical role. An excellent system must be in place to ensure that the movement of materials and final product are uninterrupted.

Warehousing also plays an important role in today's business environment. The company has a centralized warehouse to meet the needs of all its stores. This would not be the most efficient way. The company must evaluate creation of additional storage facility which would ensure timely delivery goods to the stores. Newer products can reach the market faster.

Benefits of SCM to Sun Electronics

SCM looks at the entire value chain process as an integrated process. There is a seamless flow of information and products between suppliers and customers. The customer's requirements would be captured to plan the production. The supplier would be intimated to supply the materials according the the production plan. An effective logistics system ensures that movement of materials is seamless. Sun Electronics can also consider implementing an integrated ERP which would also interact with vendors on real time basis.

The following benefits of SCM can be envisaged for Sun Electronics-

- Better Customer Service as customer is supplied with what he/she wants in the minimum time.
- Better delivery mechanism for goods.
- Improves productivity across various functions and departments.
- Minimises cost (both direct and indirect).
- Reduces the inventory holding time and improves the working capital cycle.
- Enhances inventory management and assists in implementation of JIT systems.
- Assists companies in minimising wastes and reduce costs.
- Improves supplier relationship.

E-Commerce and SCM

The SCM is the backbone of E-commerce industry. Customers buying products online want deliveries to be faster. Another distinct feature of e-commerce is that buyers could be located in any corner of the country and not just restricted to the cities where Sun Limited has physical presence. This definitely means that the company must have an effective Supply Chain Management in place which could meet the customer's requirement.

The existing practice of one order per month from each store would not work in the e-commerce space. Orders can come at anytime and from anywhere. Supply Chain Management would be required for success of e-commerce business.

Customer Orders

The company must have an effective mechanism to capture customer orders and feed it into the production planning on a real time basis. An integrated ERP system would be required for this purpose. Any delay in intimating the production team would mean delay in production and delivery which would not be taken positively by the customers. The existing system of one order per month from a store would not fit the purpose. A real time flow of information would mean lower inventory holding.

Procurement

The material requirements must be communicated to suppliers seamlessly. The company must identify those vendors who can delivery quality materials in the required time frame. A delay in supplies would delay the production process. A company cannot afford this in e-commerce business. Automatic exchange of information using EDI (Electronic Data Interchange) or Integrated ERP systems would ensure that the vendors receive material requirements in a timely manner.

Production

As discussed earlier, the production must be in accordance with the customer order. This requires a shift in approach of the production team. Business environments have shifted from “Customer will buy what we produce” to “We have to produce what the customers require”. The company would ideally not produce products to store them and sell later.

Logistics

Logistics would be the backbone of entire e-commerce set up. Right from sourcing of materials to delivery of products at the customer’s door step, logistics would play an important role. If the company has an in-house logistics facility, the logistics team must be trained with the requirement of the new business. If the company has outsourced the logistics, vendors must be briefed about the requirements of the e-commerce. The company might have to tie up with new logistic vendors to avoid any delay in deliveries.

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