STUDY UNIT ONE

STRATEGIC MANAGEMENT, PLANNING, AND PERFORMANCE MEASURES

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This study unit is the first of five covering **Domain I: Business Acumen** from The IIA's CIA Exam Syllabus. This domain makes up 35% of Part 3 of the CIA exam and is tested primarily at the **basic** cognitive level. Performance measures and business processes are tested at the **proficient** cognitive level. The five study units are

- **Study Unit 1: Strategic Management, Planning, and Performance Measures**
- Study Unit 2: Organizational Behavior
- Study Unit 3: Leadership and Organizational Structure
- Study Unit 4: Business Processes and Data Analytics
- Study Unit 5: Project Management and Contracts

The **learning objectives** of Study Unit 1 are

- Describe the strategic planning process and key activities (objective setting, globalization and competitive considerations, alignment with the organization's mission and values, etc.)

- Examine common performance measures (financial, operational, qualitative vs. quantitative, productivity, quality, efficiency, effectiveness, etc.)

A **strategy** is an entity's plan to

- Allocate resources and actions to succeed in its competitive environment,
- Obtain a competitive advantage, and
- Attain its highest level goals.

Performance measures, targets, and tolerances (the range of acceptable variation in performance) are established to evaluate the achievement of objectives. Performance measures must be designed so that they relate directly to accomplishment of goals. They may be financial or nonfinancial.

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1.1 STRATEGIC MANAGEMENT, PLANNING, AND GLOBALIZATION

SUCCESS TIP

An organization's strategic planning process flows from an understanding of its mission, its businesses and their markets, and the appropriate competitive strategy for each business.

Strategic Management

Strategic management is the set of decisions and activities needed to create strategies and allocate resources and actions to succeed in the entity's competitive environment.

Strategic management is a five-step process:

1. The board of directors drafts the organization's mission statement, a general statement of what the organization intends to accomplish and its reason for existing. The statement may be accompanied by one or more goals, which are specific targets for measuring the organization's success.

2. The organization performs a situational analysis, also called a SWOT analysis, involving identification of strengths, weaknesses, opportunities, and threats.

3. Based on the results of the situational analysis, upper management develops a group of strategies describing how the mission statement will be fulfilled.

4. Strategic plans are implemented through the execution of component plans at each level of the entity.

5. Strategic controls and feedback are used to monitor progress, isolate problems, and take corrective action. Over the long term, feedback can be used to adjust the original mission and goals.

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Organizational Planning

Planning generally involves setting goals and specifying the means to be used. Plans must be established at each level of a complex organization.

- At the strategic level, a **mission** statement is drafted (generally by the board of directors) to explain the organization's purposes and values. It is also the ultimate basis for the goals and plans at each level of the organization and for stating the organization's primary competitive scopes. These scopes may extend to
  - Industries,
  - Products and services,
  - Applications,
  - Core competencies,
  - Market segments,
  - Degree of vertical integration, and
  - Geographic markets.
- Businesses should also be defined in market terms, that is, needs and customer groups. Moreover, a distinction should be made between a target market definition and a strategic market definition.
  - For example, a target market for a ride share company may be people transportation, but a strategic market might be transporting items like food and groceries.
- A business also may be defined with respect to customer groups and their needs and the technology required to satisfy those needs.
- A large firm can have multiple businesses. Thus, the concept of the strategic business unit (SBU) is useful for strategic planning by large firms.
  - An SBU has its own competitors and a manager who engages in strategic planning and is responsible for the major determinants of profit.

Organizational planning has the following three phases:

1. **Plan development** includes drafting a mission statement setting strategic goals and an overall plan.
2. **Translation** of the plan at the tactical level includes
   - Establishing objectives and plans and
   - Contingency planning (including crisis prevention and preparation).
3. **Operational planning and execution** requires choosing performance targets that are
   - Specific,
   - Measurable,
   - Challenging but reasonably attainable,
   - Time limited, and
   - Related to the entity's key performance indicators.

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Implementation

Strategic plans must be passed down the organizational structure through development of plans at each lower level. This process is most likely to succeed if

- The organizational structure is compatible with strategic planning,
- Personnel have the necessary abilities,
- The organizational culture is favorable or flexible, and
- Controls exist to facilitate implementation.

Controls

Strategic controls should be established to monitor progress, isolate problems, identify invalid assumptions, and take prompt corrective action.

- As plans are executed at each organizational level, control measurements are made to determine whether objectives have been achieved. Thus, objectives flow down the organizational hierarchy, and control measures flow up.
- One category of strategic control measures relates to external effectiveness.
- A second category of strategic control measures relates to internal efficiency.
- Senior managers broadly define **strategic** goals and plans for the entire organization.

Middle managers develop **tactical** goals and plans needed to achieve strategic goals.

- Tactical plans are shorter-term and more detailed than strategic plans.

Lower managers and supervisors develop **operational** goals and plans to achieve the strategic and tactical goals and plans.

- Operational plans are short-term, detailed, and measurable at the departmental or lower levels.

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Competitive Advantage

Strategic management seeks to obtain a **competitive advantage** that differentiates the organization and allows it to be successful in its market. A competitive advantage has four aspects.

1. Strategies should be developed that target specific customers whose needs can be met by the organization.

2. The organization must be able to take advantage of **core competencies**, which are the things it does better than its competitors.

3. Strategic management is facilitated when managers think synergistically. **Synergy** exists when a combination of formerly separate elements has a greater effect than the sum of their separate individual effects.

   - **Market** synergy results when products or services have positive complementary effects. An example in the entertainment industry is a distributor's acquisition of content providers.
   - **Cost** synergy reduces costs. It occurs in many ways, for example, in the recycling of by-products or enhancing value by combining the design, production, marketing, and sales of a line of products by the same enterprise.
   - **Technological** synergy is the transfer of technology among applications. For example, technology developed for military purposes often has civilian uses.
   - **Management** synergy also involves knowledge transfer. For example, a firm may hire a manager with skills that it lacks or share management knowledge with another department.

4. Providing value to the customers is crucial to an effective strategy.

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Competitive Strategies

Competitive strategies influence a firm's relative position in its industry.

- Michael E. Porter's generic strategies model treats each competitive advantage as either a **cost** advantage (e.g., low cost) or a **differentiation** advantage (e.g., a unique product).
  - The firm's advantages should be used within its **competitive scope** (target) to achieve its objectives. This scope may be **broad** (e.g., industry-wide) or **narrow** (e.g., a market segment).
  - Using the variables of competitive advantage (cost or differentiation) and competitive scope (broad or narrow), four **generic** strategies may be implemented.

Competitive Scope	Competitive Advantage: Low Cost	Competitive Advantage: Unique Product
Broad (Industry-wide)	1 Cost Leadership Strategy	2 Differentiation Strategy
Narrow (Market segment)	3 Focused Strategy: Cost	4 Focused Strategy: Differentiation

Figure 1-1

- Quadrant 1 - **Cost leadership** seeks competitive advantage through lower costs. It has a broad scope. Such a firm can earn higher profits than its competitors at the industry average price or charge a lower price to increase market share.
  - A cost leader usually has low profit margins, high sales, a large market share, and efficient supply and distribution channels.
- Quadrant 2 - **Differentiation** seeks to provide a unique product or service. It has a broad scope. Such a firm may earn higher profits if consumers are willing to pay a higher price. But the price difference must exceed the additional cost of the differentiated product or service.
  - Successful differentiation creates a buyer belief that few, if any, substitutes are available. Thus, the firm may be able to pass supplier cost increases to buyers.
- Quadrant 3 - **Cost focus** seeks lower costs but with a narrow scope (e.g., a regional market or specialized product line). The reason is that the narrower market can be better served because the firm knows it well.
  - Firms that successfully adopt a cost-focus strategy achieve strong customer loyalty. Their strengths and attributes are similar to those of cost leaders.
- Quadrant 4 - **Focused differentiation** seeks to provide a unique product or service but with a narrow scope.
  - The analysis of these firms is similar to that for cost-focus firms.

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Operations Strategies

An operations strategy is reflected in a long-term plan for using resources to reach strategic objectives. The following are five operations strategies:

1. A **cost** strategy is successful when the enterprise is the low-cost producer. However, the product (e.g., a commodity) tends to be undifferentiated in these cases.
   - A product is undifferentiated when competitors sell essentially the same thing, such as the same kind of grain.
2. A **quality** strategy involves competition based on product quality or process quality.
3. A **delivery** strategy may permit an enterprise to charge a higher price when the product is consistently delivered rapidly and on time and deemed convenient by the customer.
4. A **flexibility** strategy involves offering many different products or an ability to shift rapidly from one product line to another or improve a product/process.
5. A **service** strategy seeks to gain a competitive advantage and maximize customer value by providing services that benefit the customer.

SWOT (Strengths, Weaknesses, Opportunities, and Threats)

SWOT analysis facilitates development of an overall strategy as a basis for planning to achieve the organization's mission. This process considers organizational strengths and weaknesses (a capability profile) and their interactions with environmental opportunities and threats.

- **Strengths and weaknesses** (the internal environment) usually are identified by considering the firm's capabilities and resources. What the firm does particularly well or has in greater abundance are its core competencies.
  - **Core competencies** are the source of competitive advantages that in turn are the basis for an overall strategy.
- **Opportunities and threats** (the external environment) are identified by considering
  - Macroenvironmental factors such as economic (e.g., changes in financial and labor markets), demographic, political, legal, social, cultural, and technological factors; and
  - Microenvironmental factors such as suppliers, customers, distributors, competitors, and other competitive factors in the industry.
- For example, speed in reacting to environmental changes or introducing new products is an important competitive advantage. To achieve it, the organization may have to reengineer its processes.

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Growth-Share Matrix

The growth-share matrix is a means of analyzing a portfolio of investments in **strategic business units (SBUs)**.

- This approach supports
  - Resource allocation,
  - New business startups and acquisitions,
  - Downsizing, and
  - Divestitures.
- The Boston Consulting Group's model for portfolio strategy has two variables.

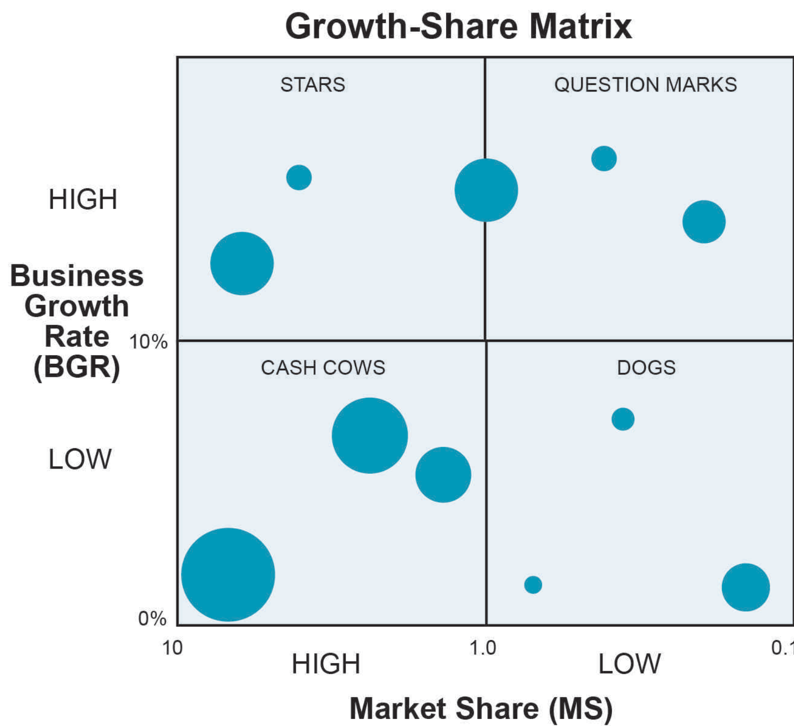

Figure 1-2

- The **business growth rate (BGR)** (also referred to as market growth rate) is on the vertical axis. It relates to
  - The maturity and attractiveness of the market and
  - The relative need for cash to finance expansion.
- **Market share (MS)** is on the horizontal axis.
- The MS reflects an SBU's position in the market segment relative to competitors.

- SBUs are represented in the quadrants by circles. A circle is proportional to the SBU's position in the entity's portfolio.
  - **Dogs** (low MS, low BGR) are weak competitors in low-growth markets. They are candidates for disposal. Net cash flow is modest.
  - **Question marks** (low MS, high BGR) are weak competitors that need cash infusions from cash cows. A question mark may become a star or a dog depending on whether MS increases significantly.

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- **Cash cows** (high MS, low BGR) are strong competitors and cash generators. A cash cow ordinarily enjoys high profit margins and economies of scale. The SBU's excess cash can be used for investments in other SBUs. But marketing and R&D expenses should not necessarily be reduced significantly.
- **Stars** (high MS, high BGR) are strong competitors in high growth markets. Such an SBU is profitable but needs large amounts of cash for expansion, R&D, and meeting competitors' attacks.

- Each SBU should have objectives, a strategy should be formulated to achieve those objectives, and a budget should be allocated.
  - A **hold** strategy is used for strong cash cows and stars.
  - A **build** strategy is necessary for a question mark with potential to be a star.
  - A **harvest** strategy maximizes short-term net cash inflow. Harvesting means zero-budgeting R&D, reducing marketing costs, not replacing facilities, etc. This strategy is used for weak cash cows and possibly question marks and dogs.
  - A **divest** strategy is normally used for question marks and dogs that reduce the firm's profitability. The proceeds of sale or liquidation are then invested more favorably.
    - A harvest strategy may undermine a future divestiture by decreasing the fair value of the SBU.

Globalization

Globalization is the degree to which ideas, information, data, investment, and trade cross national borders.

The unavoidable extent of globalization requires managers to have a global mindset. It is defined by Daft and Marcic (*Understanding Management*, 10th edition) as the "ability to appreciate and influence individuals, groups, organizations, and systems that represent different social, cultural, political, institutional, intellectual, and psychological characteristics."

- The **cognitive** element is the ability to understand cultural differences and adjust to global changes.
- The **social** element is the ability to develop relationships with people from different cultures.
- The **psychological** element is the ability to enjoy diverse modes of thought and behavior and cope with uncertainty.

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Multinationals

Multinational corporations (MNCs) also are known as global, stateless, or transnational. These entities have become numerous and powerful, some with revenues equivalent to the gross domestic products of countries.

- An MNC usually receives at least 25% of its sales from sources outside its home country.
  - Some MNCs have senior management with a global approach that treats the world as a single market (geocentric). A **geocentric** company is one where management looks at opportunities on a global scale. Instead of focusing on the way that business gets done in a given country, it looks at how to conduct business anywhere in the world, based on common ways of communicating.
- But some MNCs are not geocentric; that is, they are internationally oriented and seek to absorb the best that various cultures offer, including managerial talent.
  - **Ethnocentric** MNCs identify with the home country.
  - **Polycentric** MNCs emphasize host country markets, and control is primarily local.

The Global Environment

Management of operations in more than one country addresses the same functions as in the domestic environment: (1) planning, (2) organizing, (3) leading, and (4) controlling.

Economic issues include the degrees of development and interconnection.

Political and legal issues are complex in the international environment because of substantial statutory and regulatory differences from country to country.

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Social and cultural differences may be even more difficult to resolve than economic, legal, and political issues, but they are crucial.

- **Communication** varies because of the distinction between high-context and low-context cultures.
  - In **high-context** cultures (e.g., Japanese, Chinese, Arabic, and Korean), much meaning is transmitted by nonverbal cues and situational circumstances.
  - In **low-context** cultures (e.g., in northern European and North American countries), primary meanings are transmitted by words. For example, precise written contracts are highly valued in a low-context culture.
- **Cultural intelligence (CQ)** has been defined as the ability to observe, reason about, interpret, and respond to culturally unfamiliar situations.
- Social trends, such as changes in labor markets, reflect social, cultural, and demographic factors in the organization's macroenvironment that may constitute opportunities or threats (identified in a SWOT analysis). The attributes of people (age, education, income, ethnicity, family status, etc.) and their beliefs, attitudes, and values shape and are shaped by social trends that in turn affect the organization.

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1.2 PERFORMANCE MEASURES -- COSTS OF QUALITY

Performance Measures -- Financial vs. Nonfinancial Measures

Financial performance measures are derived from financial accounting data stated in monetary units.

Nonfinancial performance measures are not standardized and may have any appropriate form, except that nonfinancial performance measures are not expressed in monetary values.

- **Product quality** measures include but are not limited to returns and allowances and the number and types of customer complaints.
- **Manufacturing** measures include but are not limited to
  - Throughput time (the time required to convert materials into finished goods),
  - The ratio of equipment setup time to total production time, and
  - The ratio of reworked units to completed units.
- The **balanced scorecard** includes other nonfinancial measures (Subunit 1.3).

Key performance indicators (KPIs) are quantitative measures that indicate how well the company is doing.

The costs of quality must be assessed in terms of relative costs and benefits. Thus, an organization should attempt to optimize its total cost of quality.

- Moreover, nonquantitative factors also must be considered. For example, an emphasis on quality improves competitiveness, enhances employee expertise, and generates goodwill.

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Conformance costs include costs of prevention and costs of appraisal, which are financial measures of internal performance.

- **Prevention** attempts to avoid defective output. These costs include
  - Preventive maintenance,
  - Employee training,
  - Review of equipment design, and
  - Evaluation of suppliers.
- **Appraisal** includes such activities as statistical quality control programs, inspection, and testing.

Nonconformance costs include internal failure costs (a financial measure of internal performance) and external failure costs (a financial measure of customer satisfaction).

- **Internal failure costs** occur when defective products are detected before shipment and additional costs are incurred on defective products. Examples are scrap, rework, tooling changes, and downtime.
- **External failure costs**, e.g., warranty costs (including repairs), product liability costs, and loss of customer goodwill, result when problems occur after shipment.
  - Environmental costs also are external failure costs, e.g., fines for nonadherence to environmental law and loss of customer goodwill.

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1.3 PERFORMANCE MEASURES -- BALANCED SCORECARD

Critical Success Factors (CSFs)

The balanced scorecard is a management control approach that connects CSFs with measures of performance.

The balanced scorecard also is a goal congruence tool that informs managers about the factors that senior management believes to be important.

- CSFs are specific measures that may be (1) financial or nonfinancial, (2) internal or external, and (3) short-term or long-term.
- The balanced scorecard facilitates best practice analysis. **Best practices** are methods of performing a function that are superior to all other known methods.

CSFs are vital to competitive advantage.

Measures

Specific measures for each CSF should be relevant to the success of the firm and reliably stated.

- Thus, the balanced scorecard varies with the strategy adopted by the firm.

The scorecard should include **lagging** indicators (such as output and financial measures) and **leading** indicators (such as many types of nonfinancial measures, e.g., customer satisfaction, returns, and repeat customers).

- Leading indicators should be used to predict future financial performance.

The scorecard should permit a determination of whether certain objectives are being achieved at the expense of other objectives.

- For example, reduced spending on customer service may improve short-term financial results at a significant cost that is revealed by a long-term decline in customer satisfaction measures.

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Possible CSFs and Measures

A typical balanced scorecard classifies objectives into one of four perspectives:

1. The **financial performance** perspective addresses current and long-term results.

Possible CSF	Possible Measure
Sales	New product sales
Fair value of stock	Price-earnings ratio
Profitability	Return on investment, EVA
Liquidity	Quick ratio, current ratio, net working capital

2. The **customer service** perspective includes customer retention, customers' opinions about the firm, and their level of satisfaction.

CSF	Financial Measure	Nonfinancial Measure
Customer satisfaction	Trends in monetary amounts of returns	Market share
Dealer and distributor relationships	Trends in monetary amounts of discounts taken	Lead time
Marketing and selling performance	Trends in monetary amounts of sales	Market research results
Prompt delivery	Trends in delivery expenses	On-time delivery rate
Quality	Monetary amounts of defects	Rate of defects

3. The **internal business processes** perspective emphasizes production and other operational measures.

CSF	Financial Measure	Nonfinancial Measure
Quality	Scrap costs	Rate of scrap and rework
Productivity	Change in company revenue/ change in company costs	Units produced per machine hour
Flexibility of response to changing conditions	Cost to repurpose machine for new use	Time to repurpose machine for new use
Operating readiness	Setup costs	Downtime
Safety	Monetary amount of injury claims	Number and type of injury claims

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4. The **learning and growth** perspective relates to resource management and innovation.

CSF	Financial Measure	Nonfinancial Measure
Development of new products	R&D costs	Number of new patents applied for
Promptness of product introduction	Lost revenue (from slow introduction of new products to market)	Length of time to bring a product to market
Human resource development	Recruiting costs	Personnel turnover
Morale	Orientation and team-building costs	Personnel complaints
Competence of workers	Training or retraining costs	Hours of training

Example Balanced Scorecard

OBJECTIVES	PERFORMANCE MEASURES	TARGETS	OUTCOMES	CORRECTIVE INITIATIVES
PERSPECTIVE: Financial Performance				
Increase sales	Gross revenues	Increase 15%	Increase 3%	• Expand into new markets • Improve same-store sales
PERSPECTIVE: Customer Service				
Reduce returns	Number of returns	Decrease 10%	Decrease 2%	• Reduce number of defects • Determine customer needs prior to sale
PERSPECTIVE: Internal Business Processes				
Reduce scrap	Costs of scrap	Decrease 5%	Increase 4%	• Improve employee training • Seek higher quality materials
PERSPECTIVE: Learning and Growth				
Reduce personnel turnover	Length of time employed	Increase 50%	Increase 10%	• Improve hiring practices • Reevaluate compensation plan

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STUDY UNIT TWO

ORGANIZATIONAL BEHAVIOR

2.1	*Motivational Theories and Behaviors*	*2*
2.2	*Motivation -- Process-Based Theories, Behavior, Job Design, and Other*	*8*
2.3	*Organizational Politics and Group Dynamics*	*11*

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The **learning objectives** of Study Unit 2 are

- Explain organizational behavior (individuals in organizations and groups, how organizations behave, etc.).
- Explain different organizational and motivational theories and methods (traits, organizational politics, motivation, job design, rewards, work schedules, etc.).

In the **short term** (about 1 year), the organization must meet the expectations of society, owners, employees, customers, and creditors. In the **intermediate term** (about 2-4 years), it must adapt to change and develop its capacities. In the **long term** (5 or more years), it must survive in an uncertain environment with many threats and opportunities. The ideal management action motivates subordinates (such as by rewarding them for certain actions) by structuring situations and requiring behaviors that satisfy the needs of subordinates and the organization.

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2.1 MOTIVATIONAL THEORIES AND BEHAVIORS

Overview

According to Daft (*Understanding Management*, 10th ed.), an **organization** is a “social entity that is goal directed and deliberately structured.” The four elements of an organization have been defined as follows:

1. Coordination of effort in a cooperative social arrangement
2. A common objective or purpose
3. Division of labor (efficient work specialization)
4. A hierarchy of authority
    - **Authority** is the legitimate right to direct, and to expect performance from, other people to achieve the organization’s goals. Those people are accountable to their superiors in the hierarchy.

The test of an organization is its **performance**, for example, its effectiveness and productivity.

- In the narrow sense, **effectiveness** is achievement of goals by providing value to customers over time. It should be contrasted with **efficiency**, the ratio of output to input. In the broad sense, an organization must achieve its goals efficiently to be considered effective.
- Economists define **productivity** as the ratio of real output to a unit of input.
    - For example, in a retail store, a critical output is revenue per square foot. Productivity of floor space, a limited resource, therefore should be analyzed.
    - Increased productivity is the goal of every organization because it improves the measures of performance, such as profit.
- Depending on certain factors, the existence of **competition** may result in increased or decreased productivity.
    - For example, competition between groups whose tasks are independent will result in increased productivity. But, competition between groups whose tasks are interdependent will result in decreased productivity.

The definition of **organizational effectiveness** includes a time dimension. Thus, an organization needs to be effective beyond the near future. It should be effective and efficient, grow, be profitable, satisfy society’s and its stakeholders’ expectations, learn, adapt, develop, and survive over a period of years.

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Organizational decline (inflexibility and loss of effectiveness and efficiency) may lead to downsizing, merger, reorganization, or liquidation. It results from decreased demand, resource limitations, or mismanagement.

- Management complacency is one of the main causes of organizational decline. The following are its characteristics:
  - A lack of innovation
  - Faulty perception of markets and competition
  - Failure to observe or properly appraise the initial warnings of decline
  - Not focusing on daily objectives
- Downsizing results from organizational decline, changes in the business cycle, or business combinations. The objectives are cost reduction, improved efficiency, and higher profits.

Organizational charts represent the formal organizational structure in two dimensions: vertical hierarchy and horizontal specialization. They often resemble a pyramid, with the chief executive on top and the operating workforce on the bottom.

- Lines show reporting relationships, lines of authority, and task groupings. An organizational chart also depicts promotional or career tracks and illustrates the span of control and the number of organizational levels.
- A shortcoming is that organizational charts do not show informal relationships, e.g., communication, influence, power, or friendship.
- Recent trends in management, including increased **span of control** and decreased hierarchy, have resulted in flatter organizational charts.

Motivation is the set of internal and external forces that stimulate enthusiasm to persist in a course of action.

Rewards

Extrinsic rewards are received from others.

- Social rewards normally include acknowledgment of employee achievement through actions, such as solicitation of advice.
- Token rewards are normally nonrecurring. They show appreciation for the role of the employee. Examples are stock options, additional time off with pay, a stipend for employee of the month, etc.
- Extrinsic threats and punishments use fear to motivate. An example is charging overweight employees more for health insurance.
  - This practice is based on **loss aversion**, the tendency to respond more to a loss than a possible gain (e.g., a monetary reward for weight loss).

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Intrinsic rewards are the internal satisfactions that result from certain actions. Examples are enjoyable work and accomplishment of fulfilling tasks.

- Intrinsic anxieties and self-doubts may be exploited by managers, for example, the fear of unemployment during a recession.

Under the relative incentive scheme, workers' pay depends on the ratio of individual productivity to average productivity among all co-workers in a field. Under the absolute incentive scheme (piece rates) individual pay only depends on individual productivity. According to **equity theory**, employee motivation is affected significantly by relative as well as absolute rewards. An employee compares the ratio of what (s)he receives from a job (outcomes such as pay or recognition) to what (s)he gives to the job (inputs such as effort, experience, ability, or education) with the ratios of relevant others.

- If the ratios are equal, equity exists. If they are unequal, inequity exists, and the employee will be motivated to eliminate the inequity.
  - Responses may be to alter (1) inputs to the job (exert less effort), (2) the outcomes (e.g., asking for a raise), or (3) the perceptions (e.g., by inflating job status).
  - An extreme response is to leave the job.

Need-Based Theories of Motivation

According to Abraham Maslow, human needs are a hierarchy, from lowest to highest. Lower-level needs must be satisfied before higher-level needs can influence (motivate) the individual.

Maslow's **hierarchy of needs** is listed below, from lowest to highest:

- **Physiological needs** are the basic requirements for sustaining human life, such as water, food, shelter, and sleep. Until these needs are satisfied to the degree needed to maintain life, higher-level needs will not be motivators.

- **Security or safety needs** include protection from physical or emotional harm, the loss of a job, and other threats.

- **Affiliation or acceptance needs** are the needs of people as social beings for love, affection, friendship, and belonging.

- **Esteem** is the need to be valued by both one's self and others. These needs are satisfied by power, prestige, status, and self-confidence.

- **Self-actualization** is the highest need in the hierarchy. It is the need to realize one's own potential for growth and continued development.
  - Thus, the job itself is an intrinsic motivation; no extrinsic motivation (such as rewards or reinforcements) is needed. Intrinsic motivation provides the worker with psychological utility.

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